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Hearing

1 UNITED STATES DISTRICT COURT
2 SOUTHERN DISTRICT OF NEW YORK

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3 BITVESTMENT PARTNERS LLC,

4 Plaintiff,

5 v.

13 CV 7632 (RWS)

6 COINLAB, INC., CLI HOLDINGS,
7 INC., ALYDIAN INC., PETER
8 VESSENES and JOHN DOE,

Defendants.

9 -----x

10 New York, N.Y.
11 November 20, 2013
12 3:06 p.m.

13 Before:

14 HON. ROBERT W. SWEET,

15 District Judge

16 APPEARANCES

17 REYHANI NEMIROVSKY LLP
18 Attorneys for Plaintiff
19 BRYAN ISAAC REYHANI

20 LOEB & LOEB LLP
21 Attorneys for Plaintiff
22 DANIELLE JANINE KIWAK

23 NESENOFF & MILTENBERG, LLP
24 Attorneys for Defendants
25 MARCO AURELIO SANTORI

BRESKIN JOHNSON TOWNSEND PLLC
Attorneys for Defendants
ROGER M. TOWNSEND

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1 (In open court)

2 THE COURT: Please be seated. Yes.

3 MR. SANTORI: I think we're waiting for plaintiff's
4 counsel.

5 THE COURT: No, I'm not waiting.

6 MR. TOWNSEND: Thank you, your Honor.

7 THE DEPUTY CLERK: I'll go find them.

8 MR. TOWNSEND: May it please the Court, my name is
9 Roger Townsend. I represent defendants CoinLab and Peter
10 Vessenes.

11 I want to correct at the outset one of the
12 implications of your Honor's question. There are more issues
13 here than just the out clause in the contract. At the
14 outset the most significant issue, I believe, is whether this
15 is a money damages case and whether or not any ultimate
16 judgment that could be proven at trial can be satisfied by
17 dollars.

18 And I think --

19 THE COURT: Well, that I don't care about today, the
20 ultimate trial. What I'm dealing with is this application for
21 a preliminary injunction.

22 MR. TOWNSEND: Right, your Honor.

23 THE COURT: And if you're correct that there can't be
24 money damages, then that's irreparable harm.

25 MR. TOWNSEND: It can be money damages is my

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1 contention.

2 THE COURT: Oh, you're saying it can't.

3 MR. TOWNSEND: Your Honor, even Mr. Gallancy
4 concedes --

5 THE COURT: Fellows, it's been a lovely day. I've
6 enjoyed every minute of it. We have until 4 o'clock. If you
7 want to put on any testimony, put the testimony on. As far as
8 the argument is concerned, we'll worry about that when the time
9 comes.

10 MR. TOWNSEND: Okay. Well, let me just rush through
11 it in three minutes then, your Honor.

12 I think that it is undisputable that bitcoins are
13 currency. It's the testimony of the Department of Treasury.
14 It's the clear precedent that other courts have done this. It
15 is equivalent, if anything, to a stock, and the precedent of
16 this Court is clear that a case for stock damages can be
17 determined by money damages.

18 Importantly -- and the testimony will come to this --
19 will show that the stay must apply in order for the creditors
20 in the Alydian bankruptcy to get valid, because the individuals
21 that are in this courtroom, as well as three others, are the
22 individuals who are employees or contractors of CoinLab, are
23 those that are managing the Alydian project. So if they are
24 pulled out from this case and brought in --

25 THE COURT: Well, look, forgive me, but I don't think

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1 I have anything to do with Alydian.

2 MR. TOWNSEND: You're right, your Honor, but these
3 witnesses do. These witnesses manage the Alydian project. So
4 if your Honor enters an order that says these individuals need
5 to jump off of Alydian and use best efforts to --

6 THE COURT: Whatever happens to Alydian, it's not my
7 affairs.

8 MR. TOWNSEND: Right, your Honor, but under the Second
9 Circuit precedent, if there's a commonality of interest and if
10 these individuals -- if you enter an order that says these
11 individuals need to come out and use best efforts the mine
12 bitcoins --

13 THE COURT: Well, I've already ordered that. I've
14 already ordered bitcoins to make best efforts, I believe.

15 MR. TOWNSEND: You have ordered CoinLab to make best
16 efforts and they have commenced that process.

17 THE COURT: Okay.

18 MR. TOWNSEND: Let me tell you what that entails and
19 what that would entail on a preliminary injunction because it
20 is not, as plaintiff's counsel represents, a matter of going on
21 Amazon and ordering like you're going to Best Buy. There are
22 very few -- and they acknowledge this -- there are very few
23 people in the world who can accomplish this project. Two of
24 them are in this room and two of them are managing it for
25 Alydian. If they're pulled away from Alydian, the creditors of

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1 Alydian will lose value. And that is exactly the instance
2 where a stay is appropriate.

3 Your Honor, what's significant in the contract is the
4 contract provides that CoinLab has to use best efforts to mind
5 bitcoins.

6 THE COURT: Yes.

7 MR. TOWNSEND: CoinLab has never mined bitcoins; has
8 no bitcoins mined. So under the contract, there are no
9 bitcoins due. That is an undisputable fact, your Honor, and
10 the evidence will show that.

11 CoinLab may possess bitcoins, but it's no different--
12 it's a currency. It's no different than CoinLab possessing
13 dollars or a company that is due dollars possessing dollars.
14 In fact, it's evidence that a preliminary injunction should not
15 issue because if they can satisfy a judgment at the end of the
16 day, after a trial, then it's a reason why there's no
17 irreparable harm and any damage that they could establish could
18 be satisfied.

19 So the fact that CoinLab may or may not have
20 bitcoins -- and they do -- in fact supports denial of a motion
21 for preliminary injunction. Moreover, your Honor, plaintiff
22 concedes that these bitcoins are fungible. They said, hey,
23 we'll take the bitcoins you've got, we'll take the bitcoins
24 you've mined, we'll take bitcoins from anywhere. Is that not a
25 concession, your Honor, that the bitcoins are fungible? They

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1 are like a dollar. We could have a \$20 bill here, a \$20 bill
2 there. They're both worth \$20. In fact, that's exactly what
3 plaintiff wants. I'll take the bitcoins you've got now, I'll
4 take the bitcoins that are mined.

5 And keep in mind, your Honor, that the obligation is
6 not to deliver bitcoins at a certain date. The obligation is
7 to mine bitcoins.

8 THE COURT: Well, I'm trying to put my finger on the
9 contract. Where is it? The contract that's the source of all
10 this.

11 MR. TOWNSEND: Your Honor, we've brought some
12 evidentiary binders that have the contract.

13 THE COURT: That's fine.

14 MR. TOWNSEND: So Tab 1 is the contract.

15 THE COURT: Oh, okay.

16 MR. TOWNSEND: No, I'm sorry, your Honor. That is
17 not-- yes, that's the contract.

18 So the obligation --

19 THE COURT: By the way, by any chance do you have
20 another one? Because I think in duplicate.

21 MR. TOWNSEND: We have one extra.

22 THE COURT: Thanks. Okay.

23 MR. TOWNSEND: The contract provides, at Section 2,
24 that CoinLab will use best efforts to mine the bitcoins. And
25 then to deliver the bitcoins mined to the Dalsa Barbour, which

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1 is allegedly renamed into Bitvestment, the plaintiff.

2 A couple of other significant clauses under paragraph
3 2. One is it's not just a matter of, say, once November 1,
4 comes you're going to deliver bitcoins. No, you've got to mine
5 them first. Again, they haven't mined any. There are no
6 bitcoins due.

7 Secondly -- and the parenthetical here is
8 significant -- it's clear under the contract that bitcoins
9 mined and bitcoins to be delivered are net of capital and
10 operational expenses. We will show you today, your Honor, and
11 the testimony of Mr. Olsen and Mr. Vessenes will show you, that
12 it is not possible under the best effort standards or otherwise
13 to mine bitcoins at a positive rate. The cost to mining
14 bitcoins exceeds the revenue from mining bitcoins. We know
15 this because we've done it. We did it with Alydian and these
16 very people who plaintiff asks to be ordered to pull away from
17 the Alydian projects and to the CoinLab projects to the
18 detriment of the Alydian creditors --

19 THE COURT: Forgive me. I heard you, but where in the
20 contract do you get to offset the expenses?

21 MR. TOWNSEND: If you look under paragraph 2, there's
22 a parenthetical and it says "CoinLab will use best efforts to
23 mine" 7,900-some-odd bitcoins "which, for the avoidance of
24 doubt, will mean" it will "dedicate 100 percent of its mining
25 output (other than mining output that is required to satisfy

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1 CoinLab's obligations to Crystal Island and mining output that
2 is required to meet CoinLab's appropriate mining operating
3 expenses and capital expenditures subject as approved by all
4 parties)..."

5 Now, plaintiffs contend they don't approve any
6 expenses, so therefore apparently it's one of those businesses
7 that has no overhead and can be just done for free. Well,
8 that's not the case. And we can testify that not only is--
9 it's a money loser, your Honor.

10 THE COURT: I understand that point. Okay.

11 MR. TOWNSEND: Okay? So that is evidence of failure
12 to establish likelihood of success on the merit.

13 And, in fact, you'll see in Tab 5 this language was
14 included per an e-mail from Mr. Gallancy on Wednesday, August
15 14th, the date of signature, which includes that parenthetical
16 to be added to the contract to make clear that delivery was net
17 of the operational and capital expenditures. Okay?

18 And, your Honor, it really shouldn't be a valid
19 dispute that operational and capital expenditures exceed the
20 revenue when the only entity that has ever engaged in bitcoin
21 mining is in bankruptcy because the operational and capital
22 expenditures exceeded the revenue. So I don't think that's a
23 very difficult call.

24 And then, finally, as your Honor identified, the
25 disclaimer of warranties is broad. It is not, as plaintiff's

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1 counsel represented, merely a matter of new technologies,
2 although there are new technologies in play, and the
3 declaration of Mr. Olsen will establish that. The chip size
4 necessary to mine bitcoins has changed dramatically over the
5 course of the bitcoin mining projects. They went from a-- and
6 Mr. Olsen can explain this at length-- 110 nanometer, or
7 nanometer, speed to a 65 nanometer. Now the state of the art
8 is 28. So the current chips that Alydian did are at 65.

9 Your Honor, I want to dispel this claim that somehow
10 CoinLab has done nothing in compliance with the best efforts
11 standards. We know from experience, again as plaintiff
12 testifies-- plaintiff argues, these guys are the guys that know
13 what they're doing about bitcoin mining; that it takes nine
14 months. It takes nine months to launch and operate a bitcoin
15 mining expenditure. But the speed of the bitcoin mining
16 network is expanding exponentially, so you really can't know
17 when you get into the project whether you're going to make
18 money on it. And under the best efforts standard, that is not
19 a requirement, that they launch into that business that's going
20 to lose money.

21 Your Honor, as you could tell, I'm rapidly rushing
22 through these points because I know we are short on time. But
23 I don't think you need to address the issues of likelihood of
24 success on the merit because I don't think there's any dispute.
25 And Mr. Gallancy's testimony, Mr. Vessenes's testimony and

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1 Mr. Olsen's testimony, the District Court in Texas, the
2 Department of Treasury, they all state that bitcoins are
3 currency. At worst, they would be equivalent to stock. These
4 are all things that are measurable in dollars.

5 The burden of having to-- I mean, the preliminary
6 injunction, proposed preliminary injunction, is outrageous.
7 It's managing a high-technology business in a way that makes no
8 sense. So if you are to order that these people are going to
9 get into a business that they know is going to lose money, they
10 know is going to require \$6 million at least of capital
11 expenditures if they only go to the current state of the art --
12 if they go ahead into the future state of the art, nine months
13 from now, it will probably cost \$20 million. We're going to go
14 spend the \$20 million, we're going to spend the \$6 million, and
15 we're going to lose money. We know that. We have that
16 experience. We're going to lose money. That should be bonded.
17 Because we could tell you today that it will cost more than it
18 will make. So that needs to be bonded at least at \$6 million
19 because we're going to lose that money. And I don't know that
20 Bitvestment is going to be able to pay that at the end of the
21 day as we get into it for improperly issued preliminary
22 injunction.

23 And, finally, I don't think there is any dispute --
24 and the proposed preliminary injunction, for reasons
25 unbeknownst to me, includes Mr. Vessenes personally under the

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1 preliminary injunction. It's totally inappropriate. He is the
2 CEO of CoinLab. He is not a bitcoin miner in his individual
3 capacity.

4 So, your Honor, I actually do not think this is a very
5 difficult case for preliminary injunction. I think a trial --
6 it's a complicated case. I think we need to have depositions.
7 I think we need to see experts. I think we need to flesh this
8 out through the benefit of discovery as to whether or not you
9 can make money on bitcoin mining. I can present to you today
10 two people who have lived this intimately for over a year and
11 who will testify under oath that you can't make money doing it.

12 And Mr. Gallancy's surfing the internet and finding
13 things on Amazon, we know-- and we refute each of these points
14 and we can do it. It would take hours to refute each of them,
15 but we can do each of them. None of them will net a positive
16 cash flow. Okay? So Mr. Gallancy thinks that this is about a
17 business that has no overhead. It is not the contract that he
18 entered into and he can not stubbornly refuse to approve
19 capital and operational expenditures and simply rely on that
20 fact.

21 Unless your Honor has any questions, I'd like to start
22 with Mr. Gallancy to testify.

23 THE COURT: With whom?

24 MR. TOWNSEND: Mr. Gallancy himself.

25 THE COURT: Okay.

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1 MR. TOWNSEND: Thank you.

2 DANIEL H. GALLANCY,

3 called as a witness by the Defendants,

4 having been duly sworn, testified as follows:

5 THE DEPUTY CLERK: Please state your full name and
6 spell your first name and last name slowly for the record.

7 THE WITNESS: Daniel H. Gallancy. D-a-n-i-e-l middle
8 initial H, G-a-l-l-a-n-c-y.

9 THE DEPUTY CLERK: Thank you, Mr. Gallancy. Please be
10 seated.

11 DIRECT EXAMINATION

12 BY MR. TOWNSEND:

13 Q. Good afternoon, Mr. Gallancy. I'm sorry, it sounds like
14 I'm mispronouncing your name. It's Gallancy. Is that
15 correct?

16 A. Yes, that's correct.

17 Q. And you're a chartered financial analyst. Is that right?

18 A. That's correct.

19 Q. And what training did you receive to become a CFA?

20 A. I passed a series of exams and satisfied a series of work
21 requirements.

22 Q. And that's how long a process?

23 A. The exams take approximately three years. There are ways
24 to do it a little bit faster, but approximately three years.

25 Q. And you took three years to do it?

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Gallancy - direct

1 A. Yes, sir.

2 Q. And in your capacity as a CFA, you have knowledge of
3 complex financial models. Is that right?

4 A. I have knowledge of financial models.

5 Q. Okay.

6 A. Complexity is a matter of subjectivity.

7 Q. Sure. But you regularly construct financial models. Is
8 that right?

9 A. I have in the past regularly constructed financial models,
10 yes, sir.

11 Q. And usually, in your experience in constructing financial
12 models, most businesses have overhead. Is that right?

13 A. Yes, sir.

14 Q. And in the contract that you entered into with CoinLab and
15 Alydian, that contemplated that you would be paid bitcoins
16 mined by CoinLab. Is that right?

17 A. I'm sorry?

18 Q. In the contract that you entered into with CoinLab and
19 Alydian, that contemplated that you would be delivered bitcoins
20 that were mined by CoinLab or Alydian. Is that right?

21 A. The contract said I was to receive 100 percent of CoinLab
22 and Alydian and CLI Holdings' mining output, with the exception
23 of that which is to go to Crystal Island were they to
24 participate in the deal, and operating and capital expenditures
25 as approved by all parties.

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Gallancy - direct

1 Q. Correct.

2 And so it was contemplated at that time that the net
3 of bitcoins would be less payments to Crystal Island. Right?

4 A. That's correct.

5 Q. And net payments for capital and operational expenditures.
6 Correct?

7 A. Not necessarily.

8 Q. Okay. Why not necessarily?

9 A. The project, if fully capitalized, needn't use mining
10 output for capital expenditures but, rather, would use the
11 input capital for capital expenditures and operating expenses.

12 Q. And upon what basis do you believe that outside money would
13 fund capital and operational expenditures?

14 A. On the basis of discussions with the defendant.

15 Q. Who specifically?

16 A. Peter Vessenes and the rest of the CoinLab team.

17 Q. And they told you that they would just absorb all of the
18 operational and capital expenditures?

19 A. We had discussed various different scenarios, amongst them
20 the usage of input capital for operating and capital
21 expenditures. And also amongst them the usage of mining output
22 for capital and operating expenditures. The primary source of
23 capital expenditures was to be the input capital.

24 Q. Okay. But certainly it was contemplated that at least a
25 portion, you'll acknowledge --

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Gallancy - direct

1 A. I will not acknowledge. That's not the case.

2 Q. Well, isn't that what you just said?

3 A. I said under certain circumstances. We had contemplated
4 several different deal structures.

5 Q. And you believed you had a veto right for any capital and
6 operational expenditures. Correct?

7 A. I have a veto right for any capital and operational
8 expenditures which I did not intend to use unless the defendant
9 made it such that I had to.

10 Q. And you did use it. Correct?

11 A. I attempted to use it.

12 Q. Okay.

13 A. Although without any real success.

14 Q. Okay. And you would acknowledge that the veto right for
15 capital and operational expenditures was also a right that all
16 parties had. Right?

17 A. Yes.

18 Q. All right.

19 A. That's true. For mining output, that is correct.

20 Q. So CoinLab could elect not to spend capital and operational
21 expenditures for mining output. Correct?

22 A. CoinLab could elect not to use the funds from its mining
23 output to fund capital or operating expenditures as long as it
24 fulfilled its requirements to -- if Crystal Island were to
25 invest -- Crystal Island and as long as it were to fulfill its

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Gallancy - direct

1 operations to Bitvestment.

2 Q. Well, it doesn't say that, does it?

3 A. It does say that.

4 Q. It says that they only have a veto right provided they paid
5 you first?

6 A. The language in the contract says that CoinLab will provide
7 100 percent of mining output until such time that Bitvestment
8 receives 7,984-some-odd bitcoins with the exception of mining
9 output that would go to Crystal Island or capital and operating
10 expenditures as approved by all parties.

11 Q. Okay.

12 A. To be clear.

13 Q. And so, therefore, if CoinLab doesn't approve the capital
14 and operational expenditures, it won't get spent. Correct?

15 A. Well, the first part of the sentence says "CoinLab is to
16 provide 100 percent of mining output until Bitvestment receives
17 7,984 bitcoins."

18 Q. So when it says the veto right applies to all parties,
19 what you're really saying it is only applies to you. Is that
20 right?

21 A. No, I'm saying that the veto right would only be-- that's
22 incorrect.

23 Q. Okay.

24 A. To be clear --

25 Q. They have the right to the same under the contract.

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Gallancy - direct

1 Correct?

2 A. Fair enough.

3 Q. It applies to all parties equally. Correct?

4 MR. REYHANI: Objection. Asked and answered like
5 three times already.

6 THE COURT: Overruled.

7 MR. TOWNSEND: Well, the answer keeps changing, so I
8 just want to make clear.

9 Q. Each party has a right not to spend the capital and
10 operational expenditures. Correct?

11 A. I suppose.

12 Q. Thank you.

13 And if they don't expend capital and operational
14 expenditures, then necessarily they're not going to mine
15 bitcoins. Right?

16 A. No, absolutely not correct.

17 Q. And why is that?

18 A. Because if the project is capitalized in the first place as
19 contemplated, and as it was, the input capital would be
20 sufficient to cover capital and operating expenditures. That's
21 the whole point.

22 Q. In your capacity as a CFA, do you recommend that people
23 engage in businesses that lose money?

24 A. I don't make recommendations that people engage in
25 businesses one way or the other in my capacity as a CFA. I

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Gallancy - direct

1 analyze companies.

2 Q. Okay. And you analyzed this company, Alydian. Correct?

3 A. Correct.

4 Q. You did a detailed financial model of Alydian, did you
5 not?

6 A. I did a detailed financial model that would be for this--
7 that would be for a mining project for Alydian and/or CoinLab
8 and/or CLI Holdings.

9 Q. Okay. So that's a yes. Right?

10 A. I just answered your question, sir.

11 Q. So you did a detailed financial analysis of the proposed
12 mining operation that was being run by Hans Olsen and Peter
13 Vessenes and the companies that they work for. Is that
14 right?

15 A. Among other participants, yes.

16 Q. Okay. And you didn't produce that financial analysis, did
17 you?

18 A. Produce it?

19 Q. In this litigation.

20 A. I didn't present a copy of it, no. I presented it to
21 Crystal Island, to Cedar Hill.

22 Q. But you haven't provided it to the Court or in this
23 litigation?

24 A. It was not requested.

25 Q. Okay. But you didn't use it-- you have the burden of proof

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Gallancy - direct

1 in this litigation. Right? Okay.

2 You would agree that bitcoins are an inherently risky
3 and speculative investment, would you not?

4 A. I would agree that bitcoins possess significant risks,
5 yes.

6 Q. And you would further agree that bitcoin mining is a risky
7 and unproven investment. Is that right?

8 A. I would agree that bitcoin mining has its risks. It's not
9 unproven insofar as whether or not it is achievable. It is
10 certainly achievable.

11 Q. Is it achievable with a positive cash flow?

12 A. Depending on its execution, yes.

13 Q. Okay. And you didn't provide any evidence of any positive
14 financial models that shows any bitcoin operation that
15 generates a positive cash flow, did you?

16 A. I did, indeed, provide that sort of model to Crystal
17 Island, Cedar Hill, and they, indeed, upon that model were
18 willing to invest.

19 Q. Okay. But you didn't provide it in support of your motion
20 for preliminary injunction, did you?

21 A. I didn't provide it in this particular case, no. I
22 provided it in the past to those who were interested in the
23 investment.

24 Q. So you don't have any evidence to present now or in any way
25 in this proceeding that supports that --

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Gallancy - direct

1 A. I don't have my laptop computer with me, no, sir.

2 Q. And you recommended to Cedar Hill-- first of all, who is
3 Cedar Hill?

4 A. It's an investment fund.

5 Q. Okay. And what's your relationship with Cedar Hill?

6 A. Its principals are people with whom I'm friendly.

7 Q. Okay. And who is Crystal Island?

8 A. Crystal Island is a subsidiary of Cedar Hill.

9 Q. Okay. And then at some point they engaged you to do
10 financial planning. Is that right?

11 A. They did not engage me to do financial planning. They
12 engaged me to assist them with the diligence of this deal.

13 Q. Okay. And did they pay you for that?

14 A. No, they did not.

15 Q. And why did you do --

16 A. There was an offer of compensation subsequent to the deal
17 if it were-- if they were to go through with it.

18 Q. Okay. And what was that compensation?

19 A. We were actually still in the middle of negotiating it. So
20 there was not a final specific amount, but it was likely to be
21 5 percent of the profits from the deal.

22 Q. Okay. So that was a profit-based deal?

23 A. Correct. So obviously I thought it would be profitable.

24 Q. Right.

25 You also testified in your declaration that you

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Gallancy - direct

1 thought that the project was grossly mismanaged. Is that
2 right?

3 A. The project, prior to the arrival of Hans, I believe was in
4 the past grossly mismanaged.

5 Q. Okay. But you put in your declaration that the project was
6 grossly mismanaged, right?

7 MR. REYHANI: Objection. Asked and answered.

8 THE COURT: Overruled.

9 Q. You can answer.

10 A. Yes, I believe that the project was in the past grossly
11 mismanaged. That's correct.

12 Q. Okay. And despite the gross mismanagement, you recommended
13 to Crystal Island and Cedar Hill that they invest money. Is
14 that right?

15 A. Because it was essentially under new management.

16 Q. Right. But you specifically stated in your declaration
17 that it was Mr. Vessenes that was responsible for the gross
18 mismanagement. Right?

19 A. Yes. And, thankfully, Mr. Olsen came along and did his
20 best to save the day.

21 Q. Right. But they went into bankruptcy, didn't they?

22 MR. REYHANI: Who's "they"?

23 Q. Alydian went into bankruptcy. Correct?

24 MR. TOWNSEND: Thank you.

25 A. So, yes, Alydian did indeed go into bankruptcy, but I don't

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Gallancy - direct

1 believe that's because it had negative cash flow.

2 Q. And upon what basis do you allege that?

3 A. Well, I don't have all of the data from Alydian.

4 Q. Thank you. That's --

5 A. But your --

6 Q. That's enough.

7 A. But your colleague made it clear to me he was going to file
8 for bankruptcy if I pursued this litigation.

9 Q. Well, you don't know the financial model of Alydian, do
10 you?

11 A. I created one several months ago for Cedar Hill.

12 Q. Right.

13 A. I don't have their internal-- I do not have CoinLab's
14 internal model, no. I have an older version of it. I do not
15 have a current version of it.

16 Q. So you have no idea what happened between August of 2013
17 and the time they filed for bankruptcy. Is that right?

18 A. I don't have a full and complete picture of that, no. I do
19 know that the price of bitcoin has increased.

20 Q. You also know that the speed of the bitcoin network has
21 increased exponentially as well. Is that right?

22 A. As was contemplated in the original model.

23 Q. But it's increased at a much faster rate that was
24 contemplated in the original model. Right?

25 A. No, we had various different-- well, hold on. Whose model?

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Gallancy - direct

1 Vessenes's model or my model?

2 Q. No one's seen your model, so we don't know about your
3 model. So we have to talk about Alydian's model

4 A. So I don't remember the details of Alydian's model
5 specifically. I do know that in my model, and in my model in
6 discussions with Cedar Hill, we had contemplated various rates
7 of increase in speed, as high as and, in fact, in crazy cases,
8 far higher than that which has actually occurred.

9 Q. Okay. Well, Mr. Vessenes and Mr. Olsen can talk about what
10 actually occurred based on the reality of the situation.

11 You agree in the agreement to bear all the risk from
12 any changes in future laws, regulations, changes in technology
13 and other forces not within CoinLab's control. Is that
14 right?

15 A. That, indeed, I believe is the text of the agreement, but I
16 don't have it in front of me. If you say it is, then I believe
17 so.

18 Q. And would a change in the state of the art of chip
19 technology be a change in technology?

20 A. Definitely not.

21 Q. Definitely not?

22 A. Definitely not.

23 Q. And why is that? Is a chip a technology?

24 A. A chip is a piece of silicon which has a purpose in terms
25 of its input and output.

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Gallancy - direct

1 Q. Okay. And how is that different from a technology?

2 A. I'm not really sure how to answer that question.

3 Q. I think you did.

4 A. It's not, though. The answer is no.

5 Q. Okay. Chips are not technology. I understand --

6 A. No, chips are chips. Technology -- actually, if you want
7 to look at it from a semantic basis, technology refers to a
8 broader category of items.

9 Q. Okay. Would a semiconductor be a technology?

10 A. Technology-- I don't have a dictionary definition of
11 technology in front of me.

12 Q. Would a computer be a technology?

13 A. These are examples of technological innovations.

14 Q. Okay. So the chip is a technological innovation. Is that
15 right?

16 A. A chip is one example of a technological innovation.

17 Q. Okay. And a new chip would be a new example of a new
18 technological innovation. Is that right?

19 A. That's a fair statement, yes.

20 Q. And then, also, you agreed in the same disclaimer of
21 warranties that you understand and agree that services and
22 bitcoins are the result of relatively new technologies and
23 market exchanges. Is that right?

24 A. The technologies in that paragraph don't refer to --

25 Q. Well, I'm actually going to change your focus to the

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Gallancy - direct

1 "market exchanges" language. So moving on --

2 A. So I don't know exactly what the words "market exchanges"
3 in that context means. If he's referring to-- if the
4 contract-- if that means are there new bitcoin exchanges,
5 there are new exchanges that will trade fiat currency for
6 bitcoins.

7 MR. TOWNSEND: May I approach, your Honor?

8 THE COURT: Sure.

9 Q. I'm going to hand you that and I'll ask you to look at it.
10 I'd draw your attention to Tab 2.

11 A. Yes, sir.

12 Q. Do you recognize this document?

13 A. I do, indeed.

14 Q. What is this?

15 A. This is the contract that I signed --

16 Q. You're on Tab 1, I think.

17 A. My apologies. Tab 2 is not a contract.

18 Q. No, it's not, your Honor-- I mean, no, it's not,
19 Mr. Gallancy. It's an e-mail from you. Is that right?

20 A. Indeed, it is.

21 Q. It's an e-mail that you sent on November 12th. Is that
22 right?

23 A. Yes, it is.

24 Q. And in it you're lauding a bitcoin exchange. Is that
25 right?

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Gallancy - direct

1 A. I am, indeed.

2 Q. And that bitcoin is called-- exchange is called ItBit. Is
3 that right?

4 A. It is, correct.

5 Q. And there are other coin exchanges, aren't there?

6 A. There are, indeed.

7 Q. Bitstamp.net is a bitcoin exchange?

8 A. Correct.

9 Q. BTC-e.com is a bitcoin exchange?

10 A. I believe so, yes. I haven't used that one.

11 Q. And Mt.Gox.com is a bitcoin exchange. Is that right?

12 A. Yes.

13 Q. Which bitcoin exchange do you use?

14 A. I've used several bitcoin exchanges.

15 Q. Okay. And how do they work?

16 A. I don't understand.

17 Q. How does a bitcoin exchange work? How do you get a
18 bitcoin?

19 A. The bitcoin exchange, it usually involves going to a
20 website, and the underpinnings of that website are a matching
21 engine that matches buy orders and sell orders.

22 Q. Okay.

23 A. Sort of like a-- I don't know what it's like. It's a
24 matching one.

25 Q. Is it like a stock exchange?

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Gallancy - direct

1 A. It's not really the same as a stock exchange. A stock
2 exchange-- a bitcoin exchange tends to be an amalgamation of
3 several different items that all get compressed into one thing.
4 A stock exchange is a discrete entity, like the New York Stock
5 Exchange, and then you'd have brokers going to that entity and
6 various intermediaries. So it's not quite analogous to a stock
7 exchange although it bears some similarities to it.

8 Q. But as a consumer you would pay dollars or other
9 traditional fiat-based currency and in exchange you would
10 receive bitcoins. Right?

11 A. That's one way you would do it.

12 Q. Okay. And, also, if you sold bitcoins, on those exchanges
13 you could sell a bitcoin and receive a dollar or a euro or a
14 yen or another foreign currency. Is that right?

15 A. Yes. All of this presupposes that the technology that
16 underlies bitcoins doesn't crash in the midst of this.

17 Q. Correct.

18 A. Which has happened.

19 Q. But you've used them before successfully and turned them
20 into dollars. Right?

21 A. I've used them before both successfully and unsuccessfully.

22 Q. But today if you had eight thousand bitcoins, you could
23 sell them for dollars. Is that right?

24 A. I don't know that. I probably could, but it's not certain.
25 But, yes, I probably could.

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Gallancy - direct

1 Q. Okay. And, in fact, in your declaration, you identify
2 bitcoins as a currency. Correct?

3 A. I don't have a copy of my declaration in front of me.

4 Q. In fact, you do.

5 A. Okay. Tell me what tab to look at, please.

6 Q. Turn yourself to the next tab, Tab 3.

7 A. I do.

8 Q. Okay. If you look at paragraph 5, you testify that
9 bitcoins are a virtual currency. Is that right?

10 A. "Maintained through internet pier-to-pier network." The
11 tail half of that sentence is essential.

12 Q. Okay. But you also --

13 A. Without the tail half of the sentence, the first half
14 wouldn't be correct.

15 Q. Okay. But it's a medium of exchange in which you can turn
16 dollars into bitcoins. That's how the exchange --

17 A. Wait. An exchange is or a bitcoin is?

18 Q. Well, a bitcoin can be turned into dollars. Right? We've
19 already established that. But a bitcoin is a virtual currency.
20 Right?

21 A. We haven't established that. You can at times exchange
22 bitcoins for dollars. That is not necessarily the case at all
23 times and is not necessarily the case in the future.

24 Q. It's probably the case today. Right?

25 A. It's probably the case today, yes.

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Gallancy - direct

1 Q. And, in fact, you testified or you provided testimony from
2 the director of FinCEN-- first of all, what is FinCEN?

3 A. FinCEN is an arm of the treasury department.

4 Q. And FinCEN has engaged in regulation of bitcoins. Correct?

5 A. So FinCEN -- from what I understand, I'm not a lawyer --
6 has provided guidance regarding the way bitcoin is to be
7 treated. I'm not intimately familiar with everything that
8 FinCEN has done in the bitcoin ecosystem. I have read the
9 March 2013 guidance. I don't have it with me.

10 Q. And you've also read the November 18th, 2013 testimony from
11 FinCEN as well. Correct?

12 A. I've read portions of it, yes.

13 Q. Okay. And you cite to it in your second declaration you
14 filed yesterday. Is that right?

15 A. That's correct.

16 Q. Okay. And if I draw your attention to the next tab, Tab 4,
17 paragraph 47, on page 15.

18 A. Yes, sir.

19 Q. And in that you say that the director of FinCEN testified
20 that "virtual currency is a medium of exchange that operates
21 like a currency in some environments but does not have all the
22 attributes of real currency.... And since a convertible virtual
23 currency either has an equivalent value in real currency, or
24 acts as a substitute for real currency, it qualifies as 'other
25 value that substitutes for currency' under the definition of

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Gallancy - direct

1 'money transmission services.'" Is that right?

2 A. That is, indeed, in the declaration, yes, sir.

3 Q. Okay. And so it's your understanding the Department of
4 Treasury treats the exchange of bitcoins as a money transition
5 service. Is that right?

6 A. That's, indeed, what the director of the-- what the FinCEN
7 person speaking has said, yes.

8 Q. Okay. Under the time circumstances, I'm going to say thank
9 you for your testimony.

10 MR. TOWNSEND: And unless there's a cross, we have
11 other witnesses we'd like the Court to hear.

12 MR. REYHANI: We'd like to reserve our right to recall
13 Mr. Gallancy at the conclusion of their examination.

14 THE COURT: Okay.

15 MR. REYHANI: Thank you.

16 THE COURT: That's fine. Thank you.

17 MR. SANTORI: Your Honor, I call-- by the way, this is
18 Marco Santori for the stenographer.

19 Your Honor, we call Mr. Peter Vessenes.

20 MR. SANTORI: Your Honor, what I'd like to do is give
21 Mr. Vessenes the same binder of exhibits.

22 THE COURT: Sure.

23 PETER JOSEPH VESSENES,

24 called as a witness by the Defendants,

25 having been duly sworn, testified as follows:

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1 THE DEPUTY CLERK: Please state your full name and
2 spell your first name and last name slowly for the record.

3 THE WITNESS: My name is Peter Vessenes. Peter Joseph
4 Vessenes. P-e-t-e-r J-o-s-e-p-h V-e-s-s-e-n-e-s.

5 THE DEPUTY CLERK: Thank you, sir.

6 MR. SANTORI: May I approach, your Honor?

7 THE COURT: Yes.

8 MR. REYHANI: Your Honor, if I may, is it a 4 p.m.
9 hard stop?

10 THE COURT: Pardon me?

11 MR. REYHANI: Is this proceeding a 4 p.m. hard stop?

12 THE COURT: Well, probably.

13 THE DEPUTY CLERK: We have three conferences.

14 MR. REYHANI: No, I understand.

15 MR. SANTORI: In that event, your Honor, we will hit
16 the high points of our testimony.

17 THE COURT: Okay.

18 DIRECT EXAMINATION

19 BY MR. SANTORI:

20 Q. By way of introduction, Mr. Vessenes, what is your
21 educational background?

22 A. I attended Brown University. I have a Bachelor of Science
23 degree in theoretical math and cryptography.

24 Q. And what is your business experience?

25 A. I am a serial entrepreneur largely. I've started 10 to 12

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Vessenes - direct

1 businesses. About five or six of them are still operating.

2 Q. Do you have any experience outside of those businesses?

3 A. Yes, as a management consultant. I also am chairman and
4 founder of the Bitcoin Foundation, which is the global trade
5 organization for bitcoins.

6 Q. And what is your relationship to the defendant, Alydian?

7 A. I am the managing director of Alydian.

8 Q. What about CoinLab? What is your relationship to CoinLab?

9 A. I'm the CEO of CoinLab.

10 Q. And so to put the puzzle pieces together, what is CoinLab's
11 relationship to Alydian?

12 A. CoinLab owns 65 percent of the common stock of Alydian and
13 is a creditor of approximately a half million to six hundred
14 thousand dollars to Alydian.

15 Q. So what does CoinLab mean, the name?

16 A. Well, CoinLab is-- the idea of a lab is just making --
17 making something, making something interesting. CoinLab is a
18 bitcoin incubator. We want to incubate new businesses and
19 make them. It was inspired by another incubator called
20 IdeaLab.

21 Q. So are there other incubators out there?

22 A. There are many, yeah. Betaworks is one. I think in New
23 York, five hundred start-ups. There's a German one that the
24 brothers made a couple billion dollars doing it, Rocket
25 Internet in Germany.

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1 THE COURT: When you say "incubator," what do you
2 mean?

3 THE WITNESS: It's a term of art, your Honor, which I
4 suppose denotes a business model and that model is to create
5 and launch new businesses. So you incubate them. A little bit
6 like farming, I suppose.

7 Q. Has CoinLab always been in this line of business,
8 incubation?

9 A. Yeah, it was always the plan to be an incubator. You start
10 with one. So we didn't always present to the public that
11 brand, but internally we had that idea from the beginning.

12 Q. And so then has CoinLab ever run a mining pool?

13 A. Yes, we've run a mining pool.

14 Q. Can you just explain to me, then, is a mining pool the same
15 thing as mining?

16 A. No. We've thrown around some technical terms. Bitcoin
17 mining is the act of securing the bitcoin network. You do some
18 hard cryptographic problems and math problems, and you help
19 provide overall security for this open financial network.

20 A pool, on the other hand-- now, you don't always
21 make enough money doing that mining to have some certainty of
22 your financial results. And so often those who do a little bit
23 of bitcoin mining will pool up together and a service will
24 provide them with some financial certainty and that's called a
25 mining pool.

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Vessenenes - direct

1 Q. And so we've talked about bitcoin mining.

2 What is Alydian's business?

3 A. Alydian is in the business of bitcoin mining.

4 Q. What is bitcoin mining?

5 A. Well, I said a little bit about it just now, but what you
6 should think about it is it's a pool of people who want to help
7 secure the bitcoin network. They do that through, currently,
8 custom chips, custom chip design. And in exchange they get
9 paid, paid for doing that.

10 Q. And how are new bitcoins created?

11 A. They are issued to miners in exchange for doing the
12 securing work.

13 Q. And what kind of hardware is required for bitcoin mining?

14 A. Well, there are a lot of options, but if you want to mine
15 right now in such a way that it will return more money than
16 your energy costs, you need to have a fairly sophisticated
17 piece of custom silicon or custom chip that's been built.

18 Q. Is there a specialized staffing required in addition to
19 that specialized hardware?

20 THE COURT: Let me try a definition in lay terms.
21 Bitcoin mining is using a product which generates internet
22 algorithms which enables people to make connections. Is that a
23 fair statement?

24 THE WITNESS: I think that's broadly true, your Honor.
25 What the miners really do is they take the role that the bank

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Vessenes - direct

1 fraud department would take at the bank or someone watching the
2 transactions that the Fed would take. But they kind of --
3 everyone does it together so they look over the transactions
4 and secure them.

5 THE COURT: Well, first of all, they have to locate a
6 transaction?

7 THE WITNESS: Yes. People will send them a
8 transaction and say, "Secure this for me, please."

9 THE COURT: And then they-- what do they do once they
10 get people who want to have a transaction?

11 THE WITNESS: Well, I would assume you want me to be
12 not too technical. Is that correct?

13 THE COURT: You got it.

14 THE WITNESS: What they do, they get a list of
15 transactions. If you think of any money system --

16 THE COURT: Forgive me. They've got to do-- you
17 should pardon the expression-- mining. They have to locate
18 those transactions.

19 THE WITNESS: Those are sent to them. People kind of
20 call them up and send them. They say, Hey, if you could, if
21 you mine my transaction for me, I'll give you a little money.
22 Miners make money that way. In exchange they time-stamp them.
23 And the time-stamping is the thing that keeps the network
24 secure. And it's very hard to do this. There's some clever
25 math that makes it hard, and that difficulty of finding the

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Vessenes - direct

1 time stamp is how the network sort of moderates its security
2 and money issuance.

3 THE COURT: And then, once they have the
4 identification of the transaction, what do they do?

5 THE WITNESS: As soon as it's time-stamped, the whole
6 world knows about it. And whoever was lucky enough to find
7 that time stamp gets, right now, 25 bitcoins. And they say,
8 Hey, good job, thank you for securing the network. We'll get
9 another time-stamped set of transactions in about ten minutes.

10 THE COURT: So what do you have to do to get the time
11 stamp?

12 THE WITNESS: Well, you have to do a lot of
13 computational work. Trillions and trillions of math problems.
14 So it's very, very hard to do that. And that's the bitcoin
15 mining, is those hard math problems.

16 THE COURT: And the problem that's being solved is?

17 THE WITNESS: It's impossible to describe in a
18 nontechnical way, but it's a clever problem that proves-- well,
19 I could explain it this way. You want to-- if I gave you a
20 job -- but it's just to prove you worked. Here's a job. Flip
21 coins. Videotape yourself flipping coins. And as soon as you
22 have a video of flipping 32 heads in a row, call me and show me
23 that video.

24 Now, if you called me, I would know you had done a lot
25 of coin flipping, but I'd only need to see that one video. I

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Vessenes - direct

1 would know you-- it's a 50/50 chance for every tail, so it's
2 billions of coin flips you would need to make.

3 So the bitcoin problem, the mining problem, is
4 designed to let someone review the video later without doing
5 all the work. And they know, okay, you've worked really hard
6 at securing and I can see that right now.

7 THE COURT: Excuse the interruption.

8 MR. SANTORI: Not at all.

9 BY MR. SANTORI:

10 Q. So we've heard a little bit today, and in Mr. Gallancy's
11 affidavit, about the concept of a cyber attack.

12 Is the bitcoin network vulnerable to a cyber attack?

13 A. Yes, of course.

14 Q. Is the Visa network vulnerable to a cyber attack?

15 A. Yes, certainly.

16 Q. Is it any more likely that the bitcoin network will be
17 taken down by a cyber attack than the Visa network?

18 A. I don't think so.

19 Q. Is it any more likely than the banking network being taken
20 down by a cyber attack?

21 A. I don't think so.

22 Q. Do bitcoins exist physically?

23 A. No, they're just data.

24 Q. Is there a limit to the number of new bitcoins that will be
25 created?

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Vessenes - direct

1 A. Yeah. The bitcoin network promises to only issue 21
2 million or so bitcoins.

3 Q. And when will the bitcoin network stop issuing bitcoins?

4 A. The current promise is around the year 2140.

5 Q. So in 100 years?

6 A. 127 years maybe.

7 Q. What happens then?

8 A. Well, bitcoins will continue on. And I mentioned to Judge
9 Sweet that people who want transactions time-stamped pay a
10 little bit. Miners will keep getting paid to do that
11 time-stamping and transaction acting. They're paid now and
12 they'll be paid then.

13 Q. Even a hundred years from now --

14 A. Of course we speculate, you understand, because we'll be
15 dead. Yeah.

16 Q. Well, speak for yourself.

17 A. There we go.

18 Q. So even in a hundred years from now, when new bitcoins
19 cease to be created, would it be correct to say that miners
20 will still make money even after--

21 A. Yes, they will certainly receive bitcoins in exchange for
22 mining.

23 Q. If you wanted to get bitcoins right now, what would you
24 do?

25 A. I would buy them on an exchange.

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Vessenenes - direct

1 THE COURT: I'm sorry?

2 THE WITNESS: I would buy them on a bitcoin exchange.

3 Q. Could you do anything else to get bitcoins?

4 A. You could mine them as well.

5 Q. Anything else?

6 A. Not that I'm aware of. You buy them or you make them.

7 Q. Could you buy them from somebody in person?

8 A. Oh, that's true, of course. Yeah.

9 Q. Have you personally traded bitcoins for dollars on an
10 exchange?

11 A. Yes.

12 Q. Is it difficult to do?

13 A. No, it's very easy.

14 Q. What does it take?

15 A. You send your money to an exchange with a wire transfer,
16 you load a web page and you click a button.

17 Q. If you wanted to get bitcoins a year ago, what would you
18 have done?

19 A. I would have bought them on an exchange.

20 Q. If you want to get bitcoins a year from now, what would you
21 do?

22 A. I will buy them on an exchange.

23 Q. Would you be able to buy them from somebody in person?

24 A. Yes, of course.

25 Q. Do you have any reason to believe today that you wouldn't

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Vessenes - direct

1 be able to do that?

2 A. No.

3 Q. How are prices established on these exchanges that you've
4 discussed?

5 A. It's like Mr. Gallancy said. It's an open market, which
6 I'm sure the district here knows a lot about. Bids and asks.

7 Q. On those markets, is one bitcoin worth more than any other
8 bitcoin?

9 A. No.

10 Q. Is there any reason why a merchant would accept one bitcoin
11 but not another bitcoin?

12 A. No.

13 Q. Is there any reason why a creditor would accept one bitcoin
14 but not another bitcoin?

15 A. No. In fact, even in Mr. Gallancy's complaints, he's
16 willing to accept bitcoins from multiple sources. He doesn't
17 care where they come from.

18 Q. Is a bitcoin mined today any more valuable than a bitcoin
19 mined tomorrow if in a week you sell them at the same time?

20 A. No.

21 Q. When people sell on the market, do those sellers charge a
22 premium for one bitcoin over another bitcoin?

23 A. No.

24 Q. Is a mined bitcoin worth any more than a bitcoin purchased
25 on exchange?

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Vessenes - direct

1 A. No.

2 Q. So are bitcoins fungible?

3 A. Yes.

4 Q. Dan Gallancy said that one bitcoin can be different from
5 another. Is that true?

6 A. Yeah, that's true. Maybe like \$20 bills can be different
7 from each other, but they're still fungible.

8 Q. Can one bitcoin be made to be different than another
9 bitcoin?

10 A. Yes. You could write on your \$20 bill. You could attach
11 data to anything, including a bitcoin.

12 Q. So can you, as Mr. Gallancy said --

13 A. But, I mean-- do I have a \$20? If I write on my \$20, it's
14 still, you know-- like, I can write on it, but it's still a
15 \$20. It doesn't change its moneyness to attach some data to
16 it.

17 Q. So you could take a \$20 bill and write-- could you write a
18 deed on a \$20 bill --

19 A. Yeah, you could write a contract on a \$20 bill and it would
20 still be a \$20 bill.

21 Q. Could you do the same with a bitcoin?

22 A. I suppose so.

23 Q. Would any of that have been done to the bitcoins that
24 Alydian or CoinLab could have mined?

25 A. No. No, that was never conceived of.

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Vessenes - direct

1 Q. So back to Alydian. How did Alydian come into existence?

2 A. I'm just worried about time.

3 Q. I'm sure that the Court will hurry us along if that's
4 required.

5 THE WITNESS: How are we doing?

6 Q. If we go back to Alydian, can you just tell us, very
7 briefly, how did Alydian come into existence?

8 A. It was incubated by CoinLab in the fall of 2012. That
9 means that we sourced a business model, we recruited a team,
10 and we found a capital partner to launch the business.

11 Q. And what happened in the fall of 2012?

12 A. So we raised \$500,000 and began a chip project. It went
13 okay, not great. And through the spring of 2013 we realized we
14 would need more money. We knew we needed at least a million
15 dollars at the time. Final budget for Alydian was four
16 million, so we were wrong, very wrong, about how much we
17 needed. But we sold some contracts to what we call prebuyers,
18 which counsel mentioned here. They prepurchased bitcoins from
19 us. It was a way to finance the project. And that raised as a
20 total about \$1.4 million at that time.

21 Q. And what were Alydian's obligations under those prebuyer
22 contracts?

23 A. So those contracts-- those contracts were pretty simple.
24 We would deliver bitcoins to people. If we couldn't deliver
25 them, we would refund all their money. It's actually

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1 something-- there are a few contracts CoinLab, Inc. has with
2 these prebuyers. I've been wanting to refund them since
3 Alydian went into bankruptcy, but I wasn't sure if I could
4 based on the restraining order because it's not in the ordinary
5 course of business. So we have a few of those. We'll refund
6 their money as soon as we can. And if we're able to deliver,
7 great, we would deliver the coins.

8 Q. I'd like you to turn to Tab 6 in the binder that you've
9 been provided.

10 A. Okay.

11 Q. Do you know what this is?

12 A. Yes.

13 Q. What is it?

14 A. This is the initial contract with Dan Gallancy that Alydian
15 signed.

16 Q. And who prepared it?

17 A. My lawyers prepared it.

18 Q. And how do you maintain these kinds of documents?

19 A. These are stored in paper form and then also scanned and
20 pdf'd.

21 Q. Do you maintain this in the normal course of your
22 business?

23 A. Yes.

24 Q. And is it the normal course of your business to maintain
25 these documents?

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Vessenes - direct

1 A. Yes.

2 MR. SANTORI: I'd like to introduce this document as--
3 are we anywhere yet on exhibits? I believe this would be
4 Exhibit Number 1.

5 THE COURT: Okay. Defendants' 1 is admitted.

6 (Defendants' Exhibit 1 received)

7 Q. With whom was this agreement?

8 A. This was with Daniel Gallancy.

9 Q. Is this one of those prebuy contracts that you mentioned?

10 A. It is.

11 Q. Did these prebuy contracts raise all of the money that
12 Alydian needed?

13 A. No, absolutely not. As I said, the final cost of the
14 Alydian project were roughly \$4 million, and these prebuy
15 contracts got us up to about 1.4 million.

16 Q. So why did Alydian need more capital?

17 A. Well, it's very expensive to do a chip company and, at the
18 same time, there were market forces outside our control. So
19 there were -- the bitcoin network was growing more and more
20 quickly and competitors were bringing new chip technology on.
21 So at the start of the project, everyone had 110 nanometer
22 chips. When we launched, we thought the 65-nanometer chips
23 were better than the 110; would be enough. As the project went
24 on, it became clear other people had went to 28-nanometer
25 chips. Each of these jumps requires more technology, a more

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1 sophisticated engineering team to play with them, you have to
2 purchase more equipment.

3 Additionally, the network sped up so quickly. It was
4 originally ten trillion hashes a second, 10 terahashes a
5 second. By the time we were about to deploy, it was hundreds
6 of terahashes a second. One to two hundred. It was increasing
7 1 to 2 percent a day. And we had budgeted for 1 percent a day
8 growth, but it was as much as 3 percent a day at times. That
9 meant not only did we have to buy more equipment, but every day
10 you waited, you lost 3 percent of all your future earnings. So
11 it was urgent, so we had to pay rush fees. Buy more equipment
12 and pay rush fees on top of it.

13 Q. So you said equipment, hardware, rigs. What we are talking
14 about?

15 A. It's like a computer server that only makes bitcoins. It's
16 your custom chips in it and then all the other technologies
17 around it that let you do the mining.

18 Q. Did everybody at Alydian agree that Alydian should continue
19 mining in the face of this speed increase?

20 A. No. No, in the summer there was significant debate
21 internally. Hans, who was managing day-to-day operations, was
22 not sure we should continue. The CFO at CoinLab and I
23 actually-- as Alydian ran out of money, CoinLab was putting
24 more in. Like I said, the second largest creditor now to
25 Alydian. The CFO and I had quite a discussion about it and she

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1 essentially resigned over this issue. Like it's not wise to
2 continue, but I wanted to continue doing it.

3 Q. So how did you ultimately deal with this?

4 A. Well, we tried to raise money. We had a relationship with
5 Crystal Island. They made us an offer that we couldn't accept.
6 We found another offer that we did accept to invest money into
7 Alydian. We took that. CoinLab put in more money. Actually,
8 right up until the end of the bankruptcy claims, I was pouring
9 in cash.

10 Q. Why didn't you accept Crystal Island's offer?

11 A. Two things. One is we knew we needed \$2 to \$3 million to
12 do the whole project. Crystal Island only wanted to offer like
13 one-million-something. They wanted extremely onerous terms,
14 kind of New York hard money lender terms. And they also
15 wanted -- and Dan referred to this. They wanted some, like,
16 unbounded liabilities for CoinLab that we just thought, on the
17 CoinLab side, we couldn't possibly sign up for.

18 Q. Was Crystal Island a bitcoin mining expert?

19 A. No, not particularly.

20 Q. Were they financial experts?

21 A. I would think so.

22 Q. So how did they evaluate the investment?

23 A. Well, essentially they looked at, you know, is the project
24 real? Can we actually do what we say we can do? And then they
25 looked at how hard will it be to make the bitcoins? They used

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1 the bitcoin difficulty metric to do that. We had significant
2 debate over how many terahashes a second would be coming
3 on-line or through the end of the year.

4 Q. Did they put anybody in charge of due diligence for the
5 investment?

6 A. They did.

7 Q. Who was that?

8 A. Daniel Gallancy.

9 Q. Was he satisfied with the investment after doing this due
10 diligence?

11 A. I believe so. He told me that he would recommend they go
12 ahead.

13 Q. How did you determine whether, even with an investment, the
14 business would have a chance of success?

15 A. So we built a fairly sophisticated financial model.

16 Q. I'm sorry, continue.

17 A. But, again, the salient-- well, you can-- I'll tell you
18 about the salient points when you're ready. We built a model.

19 Q. Okay. I'd like you to turn to Tab 7, please.

20 A. Okay.

21 Q. Do you know what this is?

22 A. Yes.

23 Q. What is it?

24 A. This is the summary page for one of the financial models we
25 built to assess Alydian.

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1 Q. Is this the financial model you were referring to in your
2 testimony?

3 A. Yes.

4 Q. Were there others?

5 A. Yes.

6 Q. But this is just one of them?

7 A. This is one of them.

8 THE COURT: Excuse the interruption. What we will do
9 is we will have a short recess. Maybe 10, 15 minutes.
10 Something like that. It might be a little longer. Then we
11 will resume. We will stop at 5:30 and, if we're not finished,
12 we will resume tomorrow morning.

13 (Recess)

14 MR. SANTORI: Mr. Vessenes.

15 THE COURT: You're still under oath.

16 THE WITNESS: Okay. That changes everything.

17 THE COURT: Yes, I know.

18 BY MR. SANTORI:

19 Q. Mr. Vessenes, when we left off, we were discussing your
20 financial model.

21 A. Yes, on Tab 7. Is that correct?

22 Q. Right.

23 Is this the financial model you were referring to in
24 your testimony?

25 A. Yes.

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1 Q. And who prepared it?

2 A. CoinLab and Alydian employees and contractors. So me,
3 Jodie Brady, Hans Olsen.

4 Q. And how did you prepare it?

5 A. With Excel.

6 Q. And how did you retain it?

7 A. It's kept in your standard file servers.

8 Q. Was it maintained in the normal course of your business?

9 A. Yes.

10 Q. Is it the normal course of your business to maintain such
11 documents?

12 A. Yes.

13 MR. SANTORI: I'd like to introduce this as the
14 financial model, Alydian's financial model, the document on Tab
15 7.

16 THE COURT: It's admitted. Defendants' 2, I take it.

17 MR. SANTORI: Yes, thank you, your Honor.

18 (Defendants' Exhibit 2 received)

19 Q. What does the financial model show? Actually, withdrawn.

20 Is this the entire Excel spreadsheet?

21 A. No, it's not.

22 Q. How long would the entire Excel spreadsheet have been had
23 we printed it out today?

24 A. It would have been, I think, hundreds of pages.

25 Q. Okay. And so what is this that we're looking at here?

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1 A. This is a summary at a point when we were trying to decide
2 how many terahashes of mining capacity to deliver. We had
3 three estimates: The column 230 terahashes at the top, 550 or
4 870. We had hoped to have this model so your Honor could see
5 some of the things we were thinking about. But, in summary, we
6 were projecting a 1 percent growth rate per day for the bitcoin
7 mining network. And that was, we were estimating, going to
8 yield 1,897 terahashes on the rest of the network by the end of
9 the year. In that model all of our business plans looked like
10 they made some money.

11 Q. So you said "terahashes." What are terahashes?

12 A. So, again, a hash is like a try. It's like that coin
13 flipping for bitcoin mining. A terahash, t-e-r-a-h-a-s-h, is a
14 trillion of them. And so it's a lot. It's a lot of those
15 hashes.

16 Q. What would happen had the network speed increased beyond 1
17 percent?

18 A. Well, we did some analysis on that and it seemed like at
19 1.25 percent, Alydian was marginal per day. It was very, very
20 sensitive to this growth rate. Anything over that and we
21 thought that it was unlikely to make money.

22 Q. Did Dan Gallancy see this model?

23 A. Yes.

24 Q. Have you seen any of Dan's models?

25 A. No.

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1 Q. Not one?

2 A. No.

3 Q. How did Dan see this model?

4 A. So in the course of explaining the Alydian business, we
5 reviewed this model. And the model has-- it shows that we were
6 going to reinvest capital and operating-- mining into capital
7 and operating expenses and it has returns estimates. So we
8 e-mailed this to Dan, and then he reviewed it with me on the
9 phone multiple times and also, I believe, with Jodie Brady.

10 Q. You said you e-mailed it to Dan. I'd like you to turn to
11 Tab 8.

12 A. Okay.

13 Q. Do you know what this is?

14 A. Yes.

15 Q. What is it?

16 A. This is an e-mail sent to, among other people, Dan with the
17 model attached to it.

18 Q. And who prepared it?

19 A. I did.

20 Q. Did you maintain this document in the normal course of your
21 business?

22 A. Yes.

23 Q. Is it the normal course of your business to maintain such
24 documents?

25 A. Yes.

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1 MR. SANTORI: I'd like to introduce this exhibit as
2 Exhibit 3.

3 THE COURT: It's admitted.

4 (Defendants' Exhibit 3 received)

5 Q. In the course of his due diligence, did Mr. Gallancy
6 develop his own estimate of the network speed?

7 A. I believe so.

8 Q. How do you know that?

9 A. He told me on the phone.

10 Q. Oh, and what was his estimate of the network speed?

11 A. Well, we were using end of the year as a kind of date to
12 estimate how much mining capacity there would be. And he told
13 me that Cedar Hill was estimating four thousand terahashes, but
14 that I think he said, "You and I both agree that it's going to
15 be more like two thousand." So he told me his own internal
16 estimates were about two thousand terahashes.

17 Q. What kind of a growth rate would that be?

18 A. That was a little over 1 percent. It was 1 to 1.05 per
19 day.

20 Q. So at that rate would Alydian still have been arguably
21 profitable?

22 A. I believe so. I think it could have repaid any capital
23 that it needed and its customers at that growth rate. I think
24 so.

25 Q. So now the year hasn't ended yet, but what's the total

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1 network speed right now?

2 A. Today it's five thousand terahashes.

3 Q. And you thought-- how much did you think it was going to
4 be?

5 A. Two thousand but in some time, and it grows geometrically.
6 I think Mr. Gallancy estimates in his declaration it might be
7 as much as 20,000 by the end of the year. That seems very
8 possible to me.

9 Q. Did anyone at Alydian or CoinLab believe that it would be a
10 viable company at this growth rate?

11 A. No. That gets into the 2 to 3 percent a day growth rate
12 range and no one thought that it was viable at that rate.

13 THE COURT: Why not? I think I know the answer, but
14 why not?

15 THE WITNESS: Well, your Honor, the reason is that
16 you have to share proceeds with everyone else who's mining. If
17 there's a hundred of you and you got one, you get 1 percent.
18 If there's a thousand and you got one, you get a tenth of a
19 percent.

20 So we had purchased -- you know, we were deciding how
21 much to purchase, but in the event we purchased 220 terahashes.
22 Now, if there's only going to be two thousand terahashes other
23 than us, we would get about 10 percent of all the bitcoins
24 mined. If there's five thousand or 10 or 20, we get less and
25 less bitcoins.

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1 So, you know, and the difference, it sounds like not a
2 lot, but we calculated out the annual percentage rates for 1
3 percent a day versus 3 percent a day. One percent a day is
4 about 3,700 percent a year in annual growth and we were ready
5 for that, I believe. Three percent a day is 4.8 million
6 percent a year annual growth and we just couldn't-- we couldn't
7 compete with that. That was way out of our control.

8 Q. So you just testified that the network speed changed. But
9 did anything change about the hardware required to keep up with
10 that network?

11 A. Yeah. As it gets harder and harder -- if you have older
12 technology chips, they're not as effective. They require more
13 energy. They require more data center space. So all your
14 operating costs go up if you have old technology.

15 Q. Can you explain that, the difference in that technology?

16 A. Yeah. I mean, we refer to them by nanometer range. So a
17 65-- Hans could explain much more about this. I'm not really
18 an expert. But a 65-nanometer chip like ours might cost
19 three to four times as much as a 28-nanometer chip. And
20 those, we can see some are out now and more are coming. You
21 just see this incredible growth rate where other companies have
22 very, very different operational and capital dynamics than
23 Alydian.

24 Q. So given the network speed increase that nobody expected
25 and the change in chip technology required to keep up with

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1 that, did anybody at Alydian believe that it would be-- or
2 CoinLab-- believe that it would be a viable company at this
3 growth rate?

4 A. No, no one would have ever thought at a 2 to 3 percent a
5 day growth rate that it was viable.

6 Q. I'd like you to turn to Tab 9, please.

7 A. Okay.

8 Q. Do you know what this is?

9 A. Yes.

10 Q. What is it?

11 A. This is an e-mail chain between Hans Olsen and myself and
12 some others.

13 Q. How do you retain e-mails?

14 A. They're kept by Gmail. We don't have to do anything to
15 retain them.

16 Q. Do you maintain these kinds of documents in the normal
17 course of your business?

18 A. Yes.

19 Q. Is it the normal course of your business to maintain such
20 documents?

21 A. Yes.

22 MR. SANTORI: I'd like to introduce this as
23 Defendants' Exhibit 3.

24 THE WITNESS: I think it's four.

25 THE COURT: It's admitted.

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1 MR. SANTORI: Four. Thank you.

2 (Defendants' Exhibit 4 received)

3 THE WITNESS: So we were discussing that we had chips
4 to build more bitcoin systems on the dates these e-mails were
5 sent, in mid-October. So we had already paid for those. And
6 we were trying to decide if it was worth paying to assemble
7 them and deploy them at all. And you could read Hans's e-mail,
8 which is really on the next page, the second page: "The rate
9 of network deployments continues to increase at a surprising
10 pace. It seems deployments in late November have a lot of
11 risk, but minimal or no return."

12 In general, we all agreed in the course of these
13 e-mails that we should not even reinvest in building out all
14 the chips we had. We didn't think we could make any money
15 doing that.

16 Q. So turning back to the financial model, what would the
17 financial model predict for this 2 to 3 percent increase that
18 we were seeing?

19 A. Just doom, basically. I think that's the technical term.
20 I mean massive losses.

21 Q. And what if you had already purchased all of your chips and
22 all you had to do was assemble them and install them and plug
23 them into the data center?

24 A. Well, that's what happened here. We have the chips --
25 there's a lot more to get those chips working. There's

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1 engineers and there's assembly and costs. Even in that event
2 we didn't want to do that.

3 Now, if you have a fully assembled bitcoin mining
4 system ready to go, you may or may not want to run that.
5 That's a little bit of a different situation.

6 Q. So you testified earlier that you were looking for
7 capital.

8 A. Yeah.

9 Q. What if you weren't able to find capital for Alydian on
10 workable terms? What would have happened?

11 A. We would have had to shut it down.

12 Q. Would it have been able to mine bitcoins?

13 A. No.

14 Q. Would it have been able to mine bitcoins for Dalsa Barbour,
15 Dan Gallancy or Bitvestment?

16 A. No.

17 Q. Did you discuss the possibility of shutting down with
18 anybody?

19 A. Yeah, we talked it over with the board. And then, as Dan
20 became more aggressive, we also told him it was a possibility.

21 Q. I'd like to turn to Tab 10.

22 A. Yes.

23 Q. Do you know what this is?

24 A. Yes.

25 Q. What is it?

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1 A. This is a printout of a board PowerPoint.

2 Q. Is it, though, part of a discussion that you were referring
3 to about shutting down Alydian?

4 A. Absolutely. One of many.

5 Q. Did you maintain this document in the normal course of your
6 business?

7 A. Yes.

8 Q. Is it the normal course of your business to maintain such
9 documents?

10 A. Yes.

11 MR. SANTORI: I'd like to introduce this as
12 Defendants' Exhibit 5.

13 THE COURT: It's admitted.

14 (Defendants' Exhibit 5 received)

15 Q. Does it say anywhere in this presentation that you're
16 considering shutting down?

17 A. Yes, it does.

18 Q. Where?

19 A. Well, on the "What's next?" page, which is-- it's kind of
20 in the middle of the document. It's after two that say
21 "Challenges." Then it says "Go forward options." The last
22 slide is an order-- these are different possibilities we're
23 discussing now.

24 Q. Can you refer to a number in the bottom right --

25 A. I'm sorry, the Bates number is 637. I'm sorry. So you can

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1 see here we're talking, well, maybe we keep deploying, but
2 we'll have to get additional capital to do that. Maybe we can
3 get these into retail configurations. As it happened, we
4 decided that would not be helpful. Maybe we should go to a
5 smaller geometry. Should we keep trying to find hosting or
6 maybe we should shut down.

7 Q. When you say "go to a smaller geometry," does that mean--
8 is this third-- I'll withdraw that.

9 What does that mean?

10 A. It means, you know, as I told you, we have these
11 65-nanometer chips, but they were not likely to be
12 competitive. So we were saying perhaps we should figure out
13 how to get 28-nanometer chips if we like the business and it's
14 viable.

15 Q. Did you think you had to change your technology to keep up
16 with this?

17 A. It was certain.

18 Q. Would switching to a 28-nanometer device be a change in
19 technology?

20 A. I believe so, yeah. I mean, it's a totally new technology.
21 Different machines make them. It's much harder to do. I would
22 call it a change in technology.

23 Q. Did Alydian ultimately find financing?

24 A. It did. It received financing from its seed investor,
25 X-ray Holdings, PLC.

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1 Q. And what were the terms of that arrangement?

2 A. X-ray Holdings put in 12,500 bitcoins in exchange for
3 15,000 bitcoins back essentially. I'm simplifying, but that's
4 the rough.

5 Q. Did you offer those terms to Crystal Island?

6 A. Yeah, we did. We offered terms similar to them in a
7 counteroffer.

8 Q. What was their response?

9 A. They were not interested.

10 Q. Did X-ray Holdings ever receive any bitcoins that Alydian
11 mined?

12 A. No, X-ray Holdings has received no bitcoins mined from
13 Alydian. They are the largest creditor to Alydian.

14 Q. So has Alydian mined the bitcoins?

15 A. It has, yes.

16 Q. Since December of 2012, has CoinLab mined any bitcoins?

17 A. Not to my knowledge. It's possible maybe a little bit in
18 development for Alydian, but not-- no, essentially.

19 Q. And how many would you say --

20 A. If it had, it would be like a tenth of a bitcoin or
21 something.

22 Q. I see.

23 A. De minimis.

24 Q. In early October, what was the status of Alydian?

25 A. Well, bitcoin mining speeds around the network are

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1 increasing far more rapidly than we thought. We need another
2 \$500,000 or so of parts to finish our deployment. I have
3 unhappy staff who have been working for a year and are going to
4 make no money. And then we've got a possible lawsuit with
5 Dalsa Barbour.

6 Q. How fast was the network increasing at that time?

7 A. It was increasing between 2 to 3 percent a day. Something
8 like that.

9 Q. And remind us, what growth rate had Alydian projected
10 around that time?

11 A. We had projected 1, maybe 1.1.

12 Q. So am I right to say that the network speed increased three
13 times as fast as what Alydian's projections planned for?

14 A. No.

15 Q. Well, then, how fast was the network speed increase?

16 A. As I was telling Judge Sweet, I mean, it's more in this,
17 like, 4 million percent a year range, you know, as an
18 annualized number. Just incredibly fast.

19 Q. And then what annualized number were you prepared for?

20 A. More like 3,700 percent or something. So it was like-- I
21 don't know. It was 150 times faster, or something, than we
22 thought it would be growing.

23 Q. Did Alydian's personnel believe that given this, Alydian
24 should continue?

25 A. No. But I will say that we thought there was a chance

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1 some money could be returned to creditors and we wanted to do
2 that. And so CoinLab put in some money just for a bankruptcy,
3 which it's now a creditor on, just in an effort to make sure
4 that like creditors to Alydian got something out of it.

5 Q. How much did CoinLab ultimately invest in Alydian?

6 A. CoinLab invested approximately a million dollars. So about
7 550 in equity and then another 500-ish. We're still kind of
8 sorting everything out in the bankruptcy in debt.

9 Q. Did that investment make Alydian competitive?

10 A. No. And somewhat obviously.

11 Q. Why not?

12 A. Again, we had this incredible, like, outside force of the
13 bitcoin network speed. Our chips aren't competitive anymore.
14 It's nine months to do another project and we would need to go
15 raise -- after that wonderful success, we would need to go
16 raise 6 to 15 million dollars and start immediately. Like, it
17 just didn't seem possible. With the debt stack, that left us
18 substantially insolvent.

19 Q. So what did Alydian do?

20 A. Went bankrupt.

21 Q. Why?

22 A. I think I just explained it. It was insolvent. Its
23 liabilities seemed to significantly exceed its earning
24 potential or assets.

25 Q. In the weeks preceding the bankruptcy, did CoinLab invest

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1 any more money into Alydian?

2 A. Yeah. As I said, it put in about another \$500,000 just to
3 make sure that the parts and so on would get paid for.

4 Q. Is that in addition to the one million it put in earlier?

5 A. No, it's a total of about a million.

6 Q. Okay. So please direct your attention to the next tab in
7 the exhibit.

8 A. This is 11, Marco?

9 Q. Right, 11.

10 A. Okay, thanks.

11 Q. Actually-- yeah.

12 A. I like 11. I'm down with 11.

13 Q. Just one second.

14 What's your understanding of CoinLab's obligations
15 under its agreement with Dalsa Barbour?

16 A. Well, I believe that CoinLab is required to make best
17 efforts to mine bitcoins for Dalsa Barbour. And I also believe
18 that once any mining operations that has commenced on ever
19 turned capital and operating expenses, then it is due the first
20 7,900 coins, give or take.

21 However, there's an out, which I believe is triggered
22 here, and the out is quite simple. It says if there are
23 changes in technology or market forces outside of CoinLab's
24 control, then Dalsa Barbour takes all risks. And so to my
25 mind, I don't think-- I don't believe, aside from Judge

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1 Sweet's restraining order, that we owe Dalsa Barbour
2 anything. I think it's almost incontrovertible that market
3 forces have made this an impossible business to pay back
4 capital and operating expenses. That's my belief.

5 Q. Now, today, and in their papers and in their exhibits, the
6 plaintiffs argued that CoinLab has not made best efforts to
7 mine bitcoins.

8 Would you agree with that?

9 A. No.

10 Q. I'd like you to take a look at what's behind Tab 11.

11 A. Yeah.

12 Q. Do you know what this is?

13 A. Yes, I do.

14 Q. What is it?

15 A. This is some documents we prepared in response to the TRO
16 from Judge Sweet assessing some of the suggestions that Dan
17 Gallancy made in one of his many letters as to how we might
18 mine bitcoins.

19 Q. Is it the normal course of your business to keep such
20 documents?

21 A. Yes.

22 Q. And do you maintain such documents in the normal course of
23 your business?

24 A. Yes.

25 MR. SANTORI: I'd like to introduce this as

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1 Defendants' Exhibit 5.

2 THE COURT: You're talking--

3 THE DEPUTY CLERK: Six, I think.

4 MR. SANTORI: Is it six now?

5 THE COURT: Okay. It's admitted.

6 MR. SANTORI: Tab 11.

7 (Defendants' Exhibit 6 received)

8 Q. Can you walk us through this chart, please?

9 A. Yeah, absolutely. So CoinLab has no mining equipment. It
10 needs to somehow obtain mining equipment or otherwise purchase
11 bitcoin mining in some way.

12 Q. But isn't Alydian a mining company?

13 A. I said CoinLab.

14 Q. But isn't Alydian a mining company?

15 A. Yes, but CoinLab is not. It's an incubator. It just
16 starts businesses.

17 Q. Does CoinLab have bitcoin mining hardware?

18 A. No, it doesn't.

19 Q. Could CoinLab right now begin to mine if it wanted to?

20 A. No, it has no mining equipment right now.

21 Q. Okay. So please take us through what this chart means.

22 A. So to my mind -- and I think that Dan Gallancy said
23 exactly this in his letter -- you could go buy some bitcoin
24 mining equipment and start; or, you know, there are fairly
25 sophisticated derivative-type things that lets you bitcoin mine

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1 without hardware, and he listed some.

2 So we're not done with this. I apologize that this is
3 not-- what I wanted was an expert, an independent expert, to
4 provide this testimony for us because I was very annoyed to
5 hear these intimations that, like, I'm a bad guy and I'm lying.
6 I thought, let's try and get an expert. And I said in my
7 declaration that we tried five different people, each of whom
8 we offered \$400 an hour to do this and we couldn't find anyone
9 in time. So we were a little time crunched. I worked through
10 some of the options given and then we picked the ones that we
11 thought most likely to return capital.

12 Now, Dan had suggested that we purchase eight hundred
13 terahashes of equipment, and so we used that number. Now, when
14 you purchase bitcoin mining equipment, you worry about the
15 price and also the network growth rate. In the last week, the
16 price has been between \$350 and \$900. I mean, it probably
17 changed hundreds of dollars up and down while we're talking
18 here.

19 So I wanted to assess some different prices for the
20 returns because you have to think about that as well. So if
21 you'd like, I can explain what each of these are.

22 Q. Please do.

23 A. Okay.

24 Q. To start at the top, CEX.io sells realtime bitcoin mining.
25 You buy it and they provide hashes to you. It's kind of like

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1 purchasing an energy contract. To buy eight hundred terahashes
2 there today would be \$36.6 million. Or I guess like yesterday,
3 is when I last updated these numbers, but it may be different
4 today.

5 The minimum growth rate we've seen in any two-week
6 period since the summer is 1.6 percent daily growth rate. And
7 obviously the average is between 2 and 3. So at those growth
8 rates, purchasing this raw hashing power managed by someone
9 else would have a negative return on capital, minus \$16 million
10 to minus \$25 million. And that would be at-- again, I updated
11 the bitcoin price yesterday for that. That's a \$580 price.

12 CoinTerra is what, I would say, is the most likely
13 high-technology chip provider. You can't actually buy their
14 mining rigs yet, not till March. However, they're run by a
15 very sophisticated chip design team from Samsung and they quote
16 a price that you can purchase these mining rigs. And so it
17 would be about \$2.5 million to purchase these for March
18 delivery.

19 You could look at the sea of negative numbers, but we
20 didn't find any world in which running these for two years
21 would return capital. They're all money losers.

22 Finally, one that I thought was particularly annoying,
23 it was suggested we purchase these really small USB sticks on
24 Amazon called ASICMiner. And Mr. Gallancy claims this business
25 is a market leader. They're actually out of business, so this

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1 is old stock. But were we to buy the ones he suggested and if
2 we had bitcoins at \$900, which is the peak price we've ever had
3 for five minutes ever, it would cost you \$96 million to buy
4 them and they would return, you know, hugely negative
5 numbers.

6 So to me mind -- and I think this is why I believe the
7 contract's impracticable -- I do not see-- no one has
8 suggested-- these are all suggestions from the plaintiff as to
9 how to do this, but no one has suggested a way that comes even
10 close to returning capital and operating expenses. So I don't
11 know what we do. I think the contract conceived of this exact
12 situation. Market forces outside our control make it
13 impossible to make money bitcoin mining.

14 Q. To wrap this up, I have to ask, did Alydian exercise its
15 best efforts to mine bitcoins?

16 A. Yes.

17 Q. How did it do that?

18 A. It purchased bitcoin mining chips. It had a chip design
19 project that purchased all the hardware that would be used to
20 create the bitcoin mining rigs. It went out and recruited
21 engineers and hosting companies and so on and deployed them.

22 Q. Did CoinLab exercise its best efforts to mine bitcoins?

23 A. Yes, I believe so. First by funding Alydian, when that was
24 the way we mined, and then, postbankruptcy and postrestraining
25 order, by attempting to assess the market and figure out if

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1 there's a way to do this.

2 Q. Did you ever rent warehouse space? I'm sorry, did CoinLab
3 ever rent warehouse space on Alydian's behalf?

4 A. Yeah, we've got office and warehouse space in Portland.

5 Q. What does it mean to rent this space on Alydian's behalf?

6 A. So we would enter into contracts and then we bill Alydian
7 for the net costs of the space.

8 Q. Is that standard in the incubator industry?

9 A. Yeah, it's very common to do that.

10 Q. And can you give us an example?

11 A. Yeah, like Rocket Internet does exactly that. They'll put
12 staff and-- very similar to what we've done. Staff, resources,
13 technology, all those things, and they'll charge it cost plus.

14 Q. What ability did CoinLab have to mine bitcoins itself since
15 December 2012?

16 A. We haven't had that ability.

17 Q. And why not?

18 A. We're a business incubator. So to the extent we wanted to
19 mine, we launched a company and that's the company that does
20 the mining.

21 Q. What ability does CoinLab have to mine bitcoins now?

22 A. We don't have the ability to mine bitcoins right now.

23 Q. What would it take if you did want to mine-- if you wanted
24 to deploy and manage bitcoin hardware?

25 A. One thing, we'd have to recruit a new team because our

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Vessenes - direct

1 current team is working on Alydian. We would have to-- or I
2 suppose if one of these things look like they made money that
3 didn't require a team, you could just -- you could buy it.
4 But, I mean, to do the kind of scale imagined to pay back these
5 9,000 bitcoins, you'd have probably a team of five or six
6 people, significant hosting arrangements. Hundreds of
7 thousands of dollars a month in hosting costs and staff.

8 Q. And how much would all that cost, roughly?

9 A. I mean, I gave some estimates just here in this Exhibit 11
10 for a few different things. It will vary depending on what you
11 do.

12 Q. How much would it cost in electricity alone?

13 A. Well, Alydian's electricity costs are like \$200,000 a month
14 maybe right now just for the 220 terahashes. That technology
15 could cost as much as a million dollars a month in electricity
16 if you were to scale it out to the amount that Dan Gallancy
17 wants.

18 Q. Can't you just purchase a premade bitcoin mining rig?

19 A. We assessed that here. Yeah, you can go buy them. They
20 just don't make money. They won't pay you back. So there's no
21 market assessment we've done or seen that says-- in fact,
22 actually we used-- we also use as a backup the calculator
23 Mr. Gallancy suggested to us, TheGenesisBlock.com. None of
24 those show any return of capital either.

25 Q. Mr. Reyhani said earlier that this preliminary injunction

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Vessenes - direct

1 would be in the public interest.

2 Do you agree?

3 A. No, I don't. He claimed that I had-- CoinLab had creditors
4 that I suppose the judge could force us to pay back. We want
5 to pay them back. We're actually barred from doing that now
6 because they mostly want bitcoins for their refunds and I think
7 that's outside the ordinary course of our business right now.

8 Q. Is this action hurting Alydian's ability to repay its
9 creditors?

10 A. Yeah. We've got Hans sitting here all day. He's sitting
11 here rather than working on the Alydian bankruptcy and
12 operations.

13 Q. Can Alydian continue to mine and repay its creditors
14 without CoinLab's personnel?

15 A. No.

16 Q. Will existing employees with mining expertise stay if
17 CoinLab is continued to be subject to this lawsuit for however
18 many millions of dollars?

19 A. It's speculative, but I don't think so. I mean, they're
20 helping out Alydian for personal reasons now. It's not
21 lucrative for them. I don't imagine you do that forever, it's
22 very stressful, but I don't know.

23 MR. SANTORI: Thank you, Mr. Vessenes.

24 CROSS-EXAMINATION

25 BY MR. REYHANI:

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Vessenes - cross

1 Q. Good afternoon, Mr. Vessenes.

2 A. Good afternoon.

3 Q. My name is Bryan Reyhani.

4 Isn't it true that on October 29th, 2013, around the
5 time the parties were sitting here in court, that CoinLab
6 transferred bitcoins out of its bitcoin addresses?

7 A. No.

8 Q. It's not true?

9 A. No.

10 Q. Okay. It's not true-- isn't it true that-- and I'm going
11 to use shorthand version -- that two addresses, 18AQ and 1G3C
12 are CoinLab addresses?

13 A. No, they're not.

14 Q. Whose addresses are they?

15 A. I believe those are Alydian addresses.

16 Q. Those are Alydian addresses?

17 A. I believe so.

18 Q. You understand that your counsel in a letter-- your
19 counsel, Mr. Townsend, represented on September 24th, 2013,
20 that CoinLab mined bitcoin to the following bitcoin addresses:
21 18AQ and 1G3C.

22 Was Mr. Townsend incorrect?

23 MR. SANTORI: Objection, your Honor. I believe what
24 Mr. Reyhani is referring to was settlement-- were letters sent
25 back and forth during settlement.

DBKBBITH

Vessenes - cross

1 MR. REYHANI: We didn't settle anything on this
2 document.

3 MR. SANTORI: "CoinLab has no interest in engaging in
4 costly and protracted litigation in the United States District
5 Court for the Southern District of New York, but only" --

6 THE COURT: Sustained.

7 MR. SANTORI: Thank you, your Honor.

8 MR. REYHANI: Your Honor, there was no settlement
9 offer or anything like that in the document.

10 THE COURT: Sustained.

11 Q. Are those not-- those are Alydian's addresses?

12 A. I believe so. I mean, you're kind of throwing this at me
13 here and I don't have all the books, but I believe so.

14 Q. You reviewed Mr. Gallancy's affidavit. Right?

15 A. Yes.

16 Q. Okay. So two days before Alydian filed for bankruptcy,
17 Alydian was transferring out a thousand bitcoins to another
18 address?

19 A. Yes, that's correct.

20 Q. That address, the 12zZ address, isn't it true that that
21 address holds 15,000-plus bitcoins?

22 A. I believe so.

23 Q. Your counsel stated that the bitcoin mining process,
24 generally it's a money loser. I quoted that. You stated that
25 running a bitcoin mining pool won't make you enough money.

DBKBBITH

Vessenes - cross

1 But you can generate bitcoins. Is that not correct?

2 A. Who do you mean by "you"?

3 Q. Anyone who engages in mining could generate bitcoins. Is
4 that right?

5 A. Any party who engages in mining can generate bitcoins, that
6 is correct.

7 Q. You testified before that CoinLab did, in fact, mine a
8 bitcoin or a part of a bitcoin during the course of this past
9 year. Is that not correct?

10 A. I said that it was possible.

11 Q. How would that be possible?

12 A. Well, perhaps some software, some hardware is being used in
13 tests. Again, I speculate. I have no knowledge of this, but
14 perhaps it was being used in a test environment and went to an
15 address controlled by CoinLab. Perhaps. But, again, I have no
16 knowledge that that happened.

17 Q. So that would be some third party with software or hardware
18 that would be mining that bitcoin for CoinLab?

19 A. It's totally speculative. I'm not even sure I understand
20 what you're asking.

21 Q. Can a third party mine-- can a third party be contracted to
22 mine bitcoins for CoinLab?

23 A. Of course.

24 Q. Okay.

25 A. And, in fact, I've shown you some on the sheet we just gave

DBKBBITH

Vessenes - cross

1 you.

2 Q. Okay. You stated that you're a serial entrepreneur?

3 A. That's correct.

4 Q. You signed contracts?

5 A. Often.

6 Q. Hundreds? Thousands in your lifetime?

7 A. I couldn't speculate.

8 Q. Do you believe you're bound to what you sign?

9 A. Of course.

10 Q. Okay. You testified earlier that the first bitcoin
11 contract or the bitcoin contract referred to as Defendants'
12 Exhibit 1 --

13 A. This is the Daniel Gallancy contract.

14 Q. I'm sorry.

15 Isn't it true, Mr. Vessenes, that the second contract
16 that Mr. Gallancy entered into with CoinLab was with the
17 CoinLab entity itself?

18 A. CoinLab, Inc. you're referring to, I guess?

19 Q. Yes.

20 A. Yes. We had two contracts with Dan Gallancy and the second
21 one was with CoinLab, Inc.

22 Q. And isn't it true that monies were paid to CoinLab, Inc. in
23 consideration for those contracts?

24 A. Yes.

25 Q. Okay. And isn't it true that the third contract, the

DBKBBITH

Vessenes - cross

1 amended agreement, that CoinLab, Inc. was a party to that
2 agreement?

3 A. Yes.

4 Q. And isn't it true as an affiliate you are a party to that
5 contract as well?

6 A. Me personally?

7 Q. Yes.

8 A. I don't think so. I never signed it.

9 Q. You are listed as an affiliate of CoinLab and Alydian and
10 CLI. Right?

11 A. I don't know what to say. I'm not a lawyer, but I didn't
12 ever sign a personal contract with Dan.

13 Q. Okay. On behalf of CoinLab, Inc. or in general, you
14 believe you're bound to what you sign. Correct?

15 A. Yeah. If I sign on behalf of a corporation, I'm binding
16 the corporation. If I sign on behalf of myself, I believe I'm
17 binding myself. Again, I'm not a lawyer, but that's what I
18 understand.

19 Q. But CoinLab itself, if I'm understanding your testimony,
20 never had any intent to do any mining itself whatsoever?

21 A. CoinLab, Inc. certainly intended to mine in the way that it
22 normally did business, through its subsidiary, Alydian.

23 Q. But there's no reference to how CoinLab was intending to
24 mine other than the fact that CoinLab was going to mine.

25 Correct?

DBKBBITH

Vessenes - cross

1 A. I don't understand. Which agreement are you referring
2 to?

3 Q. Any of the agreements.

4 A. We didn't talk methodologies, no.

5 Q. Right. So CoinLab is obligated to mine. Correct?

6 A. I believe given the provisos we discussed, that CoinLab,
7 Inc. is obligated to use best efforts for Dalsa Barbour. But
8 there are significant provisos that are obviously a key. I
9 mean, they're a key --

10 Q. That's your opinion. I respect that. That's fine.

11 And best efforts is a step up from commercially
12 reasonable efforts. Correct?

13 A. So I'm told.

14 Q. You're really, really obligated to do something. Correct?

15 A. Please, you're the lawyer.

16 Q. And the TRO that Judge Sweet executed ordered that CoinLab
17 use best efforts to mine and deliver about eight thousand
18 bitcoins to Bitvestment. Is that correct?

19 A. That's correct, yes.

20 Q. And you placed before the Court lots of analyses regarding
21 the costs of purchasing equipment and starting a whole new
22 venture that were going to cost tens of millions of dollars.
23 Is that correct?

24 A. Some of the estimates were in that range; some were less.

25 Q. Did you reach out to any third-party miners to contract

DBKBBITH

Vessenes - cross

1 with them to mine for you?

2 A. We got quotes from third-party miners. For instance, on
3 that sheet is CEX.io. That's a third-party miner.

4 Q. You elected not to hire them to mine Bitvestment's
5 bitcoins?

6 A. Because I don't have \$36 million and I don't believe I'm
7 bound to that when it looks like it will lose \$26 million. I
8 did not contract with them.

9 Q. There are no miners you could go to right this second and
10 say, I'm going to give you "X" dollars for you to mine
11 bitcoins?

12 A. One could do that, for sure.

13 Q. You did not do that. Correct?

14 A. That is correct.

15 Q. You differentiated earlier between CoinLab mining and
16 CoinLab running a mining pool.

17 A. Yes.

18 Q. Mining pools generate bitcoins. Is that correct?

19 A. I guess it's a matter of semantics. I think the miners in
20 the pools generate the bitcoins, not the pool itself.

21 Q. Okay. And you can incentivize those miners to mine
22 bitcoins for CoinLab. Correct?

23 A. Again, we have some speculation. One could start a mining
24 pool and incentivize miners, yeah.

25 Q. You did not on behalf of CoinLab incentivize miners to

DBKBBITH

Vessenes - cross

1 operate a mining pool to produce bitcoins for Bitvestment. Is
2 that correct?

3 A. That's correct.

4 Q. Did you make an announcement on your website, on any
5 website, or anywhere for that matter, saying that you needed
6 miners to begin to mine bitcoins for CoinLab immediately?

7 A. No.

8 Q. Because it would cost money?

9 A. No, that's not why.

10 Q. But third-party miners could have in the last three weeks
11 mined bitcoins for Bitvestment. Is that correct?

12 A. No, I don't believe they could have.

13 Q. How many bitcoins have been mined-- 50,000-plus bitcoins
14 have been mined since the TRO was executed. Is that correct?

15 A. I don't know.

16 Q. You don't know?

17 A. No, I don't know. It's changing all the time.

18 Q. It's going up, right, the amount of bitcoins that are being
19 mined?

20 A. Yes.

21 Q. It's not going down.

22 A. That's correct.

23 Q. So if you contracted with any of those miners that were
24 fortunate enough to mine bitcoins, then CoinLab would have
25 bitcoins to deliver to Bitvestment. Is that correct?

DBKBBITH

Vessenes - cross

1 A. That's not correct. Aren't you curious why?

2 Q. No.

3 So you indicated before that Cedar Hill is willing to
4 give you some financing. Correct?

5 A. That's correct.

6 Q. And they were willing to give you what I believe to be
7 about a million dollars at the time or what I really believe to
8 be 10,000 bitcoins. Correct?

9 A. I believe that's the offer we discussed, yeah.

10 Q. Okay. And you turned down that offer?

11 A. That's correct.

12 Q. And you turned that offer down because you claim the terms
13 were too onerous?

14 A. That's correct.

15 Q. Okay.

16 A. Well, not just-- there are other reasons. For instance, it
17 was about a third of the capital we thought would be needed to
18 finish the Alydian deployment. And it had requirements for
19 CoinLab that required, like, unbounded investment for CoinLab.
20 Neither of those were appealing to us. We didn't think they
21 were workable.

22 Q. So you chose not to accept Cedar Hill's money?

23 A. Of course.

24 Q. So you went to a third party to get financing. Correct?

25 A. That's correct.

DBKBBITH

Vessenes - cross

1 Q. And that's John Doe in this matter?

2 A. I don't know. You've named John Doe. That party's X-ray
3 Holdings, PLC.

4 Q. That's Brian Cartmell?

5 A. Brian Cartmell owns X-Ray Holdings, PLC.

6 Q. And what did Brian Cartmell do?

7 A. He offered us a better deal.

8 Q. What was that deal?

9 A. I told Marco about it already. The rough is 12,500
10 bitcoins in on a loan in exchange for 15,000 coins returned.

11 Q. And what were Cedar Hill's offer?

12 A. They wanted to put in only 10,000. They required 20,000
13 bitcoins back and they required possible unlimited investment
14 from CoinLab, Inc.

15 Q. Okay. But you were having various discussions with Dan and
16 whomever else as to how to structure that deal. Is that not
17 correct?

18 A. Yeah. I don't believe we got a signed term sheet from
19 them.

20 Q. But there were ongoing discussions?

21 A. Sure.

22 Q. So if you would have taken the Cedar Hill money and Brian
23 Cartmell's money, wouldn't that have put CoinLab in a much
24 better position to mine bitcoins?

25 A. I don't think so. If you're going to lose money in an

DBKBBITH

Vessenes - cross

1 investment, doubling your debt stack doesn't help you. It just
2 makes things works.

3 Q. But those 10,000 bitcoins that Cedar Hill would have given
4 you would have been worth anywhere between \$5 and \$10 million
5 today. Correct?

6 A. It's immaterial. You would have had to spend them on
7 parts. Isn't that what we're talking about?

8 Q. You don't always have to pay for delivery up front. Isn't
9 that correct?

10 A. In our business you do.

11 Q. There are terms with every vendor where you can negotiate.
12 Isn't that true?

13 A. That is not true in our business. Ask Hans about it. We
14 have to pay cash up front for almost everything.

15 Q. So Brian Cartmell or X-ray Holdings, whichever entity it
16 was, gave CoinLab the 12,5 and --

17 A. No.

18 Q. No?

19 A. No.

20 Q. What did they do?

21 A. He gave it to Alydian.

22 Q. He gave it to Alydian.

23 A. He invested it in Alydian.

24 Q. Okay. And he's the 35 percent owner of Alydian?

25 A. He's also the 35 percent owner of Alydian.

DBKBBITH

Vessenes - cross

1 Q. Okay. But had you taken Cedar Hill's money, irrespective
2 of the terms, worked it out, you would have been in a better
3 position to either buy the rigs, outsource it, do whatever it
4 was to generate bitcoins?

5 A. I disagree. I mean, you imagine a scenario that doesn't
6 exist. We never had terms from Cedar Hill that were anywhere
7 near as favorable as these terms. How can you speculate?

8 Q. Had you taken Cedar Hill's money, you would have had at
9 least another million dollars with which to play to facilitate
10 the production of bitcoins. Is that not correct?

11 A. Perhaps, but we would have had many other commitments as
12 well.

13 Q. And had you taken that money, you would have actually put
14 all the prebuyers -- it would have been in the best interests
15 of all the prebuyers, because then the bitcoins would have been
16 made a little faster--

17 A. No, that's incorrect.

18 Q. That's incorrect?

19 A. Yeah.

20 Q. Isn't it true you didn't take Cedar Hill's money because it
21 would have pushed you down in the stack of bitcoins?

22 A. No. Who's "you" by the way?

23 Q. You personally.

24 A. No. I'm a creditor to Alydian now personally, but it was
25 immaterial.

DBKBBITH

Vessenes - cross

1 Q. Isn't it true that best efforts would have required you to
2 take in Cedar Hill's money and put it to use?

3 A. No, I don't think so.

4 Q. You indicated that CoinLab and Alydian are two separate
5 companies. Correct?

6 A. That's correct.

7 Q. Different corporate structure?

8 A. Yes.

9 Q. Completely different?

10 A. Yes.

11 Q. Different tax I.D. numbers?

12 A. Yes.

13 Q. Okay. You claim in among the papers that CoinLab would
14 purchase equipment and then bill it to Alydian.

15 A. That's correct.

16 Q. Is that correct?

17 A. Yes.

18 Q. And how much were those expenses that Alydian had to pay
19 CoinLab for that equipment?

20 A. Millions of dollars, I think. I believe. I'm not the CFO.
21 In that range.

22 Q. So essentially it was CoinLab's billing to Alydian for
23 these purchases that put Alydian into bankruptcy?

24 A. If you imagine parts are free and inventory is free. I
25 mean, what do you mean? No. It's the purchasing of parts that

DBKBBITH

Vessenes - cross

1 did not generate enough money to finance the debt stack that
2 drove it into bankruptcy.

3 Q. Alydian's equipment to this day can generate bitcoins.
4 Correct?

5 A. That is correct.

6 Q. At the time you and Mr. Gallancy first discussed
7 business opportunities, isn't it true that you represented to
8 him that it was CoinLab's goal to take over 90 percent of the
9 network?

10 A. No.

11 Q. You never said that?

12 A. No.

13 Q. You are intimately aware of the changes in chip size?

14 A. Probably more than you.

15 Q. I would suspect.

16 So you've been aware over the course of the past year
17 of the change from 110 to 65 to 28. Is that correct?

18 A. Yes.

19 Q. Even prior to the August amended agreement with Dalsa
20 Barbour/Bitvestment. Correct?

21 A. I don't know about Bitvestment, but we certainly new
22 28-nanometer chips were coming.

23 Q. And you knew that before the amended agreement?

24 A. Yes.

25 Q. Okay. How many bitcoins do you have personally?

DBKBBITH

Vessenes - cross

1 MR. SANTORI: Objection. Relevance, your Honor.

2 THE COURT: Sustained.

3 Q. Have you mined bitcoins personally?

4 MR. SANTORI: Objection. Relevance, your Honor.

5 THE COURT: Overruled.

6 A. Yes.

7 Q. How have you done that?

8 A. The last time I mined it, you could use a graphics card, a
9 3D card. It would maybe cost \$150 at Best Buy. This was
10 sometime ago. 2011 probably. 2012? I don't know. Early 2012
11 maybe. Something like that. You run it in your office and it
12 makes, you know, like .024 bitcoins a day. It varies every
13 day.

14 Q. Okay. If I could turn your attention back to Exhibit 5
15 that your counsel previously showed you before. D-5.

16 A. Exhibit 5?

17 Q. Yes.

18 A. Tab 5?

19 Q. Tab 10.

20 A. Tab 10. Okay. Yes, the board meeting. Is that what
21 you're referring to?

22 Q. If I could turn your attention to the page Bates stamped
23 641.

24 A. Sure.

25 Q. You see the middle section which says "Debt Summary"?

DBKBBITH

Vessenes - cross

1 A. Yes.

2 MR. SANTORI: Which page are we on?

3 MR. REYHANI: 641.

4 MR. SANTORI: Thank you.

5 Q. And there's three lists-- there's three entities or
6 individuals listed: Cartmell, Dan Gallancy, and prebuyers.

7 A. Yes.

8 Q. You see the last column, bitcoins to be returned to
9 Cartmell were about 1.8 million and bitcoins to other prebuyers
10 were \$950,000?

11 A. Uh-huh.

12 Q. And Dan's is specifically omitted?

13 A. Uh-huh.

14 Q. Isn't it true you never intended to return the bitcoins to
15 Bitvestment?

16 A. Bitvestment I don't know anything about.

17 Q. To Dan.

18 A. To Dan Gallancy? Now, in fact, the column right next to it
19 has some numbers for him.

20 Q. But you ran a scenario where you explicitly were going to
21 exclude Dan from receiving those bitcoins.

22 A. Yeah. I believe that the business was impracticable. He
23 wouldn't be owed anything. And that's unlike the contract he
24 got out of, which allowed him rescission rights basically. But
25 he changed his contract. You can see there we're upholding all

DBKBBITH

Vessenes - cross

1 those other contracts.

2 Q. Okay.

3 MR. REYHANI: Your Honor, if I could have one minute,
4 please.

5 THE COURT: Sure.

6 (Pause)

7 MR. REYHANI: Just one or two more questions.

8 Q. Isn't it true, Mr. Vessenes, that you could put on your
9 website or start another website or whatever's most practical,
10 you could put an advertisement out there to say I'm seeking
11 miners to mine bitcoins for me and that probability-wise,
12 depending on their computing power, bitcoins would be produced
13 in a matter of days?

14 A. Bitcoins would be produced. Yes, I think I would agree
15 with that statement.

16 Q. And if CoinLab collected those bitcoins from those miners,
17 those bitcoins could be transferred rather immediately to
18 Bitvestment. Is that not correct?

19 A. No. Only after any expenses had been paid would coins go
20 to Dalsa Barbour per our agreement.

21 Q. That's your interpretation of it. I'm just saying --

22 A. That's a pretty plain language of the contract. Dan read
23 exactly that.

24 Q. Again, irrespective of that --

25 A. Okay. All right. So you grant me that there may have been

DBKBBITH

Vessenes - cross

1 some expenses associated with doing this mining?

2 Q. I'm not granting you anything. I'm asking you a simple
3 question: If CoinLab puts out a little advertisement that says
4 seeking miners, pays them something, bitcoins can be produced
5 rather immediately and turned over to Bitvestment?

6 A. No. We've got-- I mean, what do you mean "can"? Under our
7 contract? I don't understand.

8 Q. I'm just asking you in general. If you took-- forget about
9 the contract.

10 A. Do you --

11 Q. Forget about the contract.

12 A. So in a world with no contract. Yes, one can absolutely --

13 Q. Let me ask the question. Assuming arguendo --

14 A. I don't know what "arguendo" means. I'm sorry.

15 Q. For the sake of argument.

16 If you put out a website or advertisement that said
17 I'm seeking miners to mine for me--

18 A. I'm with you so far.

19 Q. -- and they mined bitcoins for you--

20 A. Yes.

21 Q. -- you would be able to turn them over to any other third
22 party if you were ordered to.

23 A. I agree, it's a money. You can move it to anyone you
24 wanted.

25 Q. You agree that it could get transferred?

DBKBBITH

Vessenes - cross

1 A. I agree.

2 MR. REYHANI: Nothing further at this time.

3 MR. SANTORI: I have only a couple of questions on
4 redirect, your Honor.

5 REDIRECT EXAMINATION

6 BY MR. SANTORI:

7 Q. Mr. Reyhani mentioned two bitcoin addresses -- I believe
8 they were 12zZ and one other one -- that were holding 15,000
9 bitcoins.

10 Where do those bitcoins come from?

11 A. Well, they're mostly-- they're purchased. Actually they're
12 from-- CoinLab purchased all those bitcoins, is probably the
13 best way to say it.

14 Q. Did CoinLab mine those bitcoins?

15 A. No, it did not.

16 Q. Did Alydian mine those bitcoins?

17 A. Alydian mined some of them, yes, and used them to pay for
18 parts, but the vast majority of them were from Brian Cartmell's
19 investment.

20 Q. Does the contract obligate you to pay Dalsa Barbour your
21 bitcoins?

22 A. No.

23 Q. Does it obligate you to use best efforts to mine bitcoins
24 and then send them to Dalsa Barbour?

25 A. Once capital and operating expenses are paid, yes, provided

DBKBBITH

Vessenes - redirect

1 that there are not market forces outside our control that make
2 it impracticable.

3 Q. Mr. Reyhani put to you a hypothetical: Why don't you just
4 make an announcement to all the bitcoin miners in the world to
5 come mine for you.

6 Why didn't you do that?

7 A. Well, any business activity like that, especially when it
8 looks like it might take millions of dollars, it might lose you
9 millions of dollars, needs some analysis, I think, to just do
10 your fiduciary duty for a corporation. So we need to know if
11 that's a good idea before we do that.

12 Q. But do you know if that would be profitable or not?

13 A. I don't believe it would be from the knowledge we have
14 right now.

15 Q. Why don't you believe it would be profitable?

16 A. Just from the analysis we have done, bitcoin mining costs
17 more to procure than it looks like it will return.

18 Q. Mr. Reyhani put to you another hypothetical: Why don't you
19 just seek out contracts with other miners to mine for you and
20 pay those miners to do it.

21 Why didn't you do that?

22 A. Same thing. There's a market price for bitcoin mining
23 right now and it did not look that the results of that mining
24 will return capital.

25 Q. Mr. Reyhani also talked about a change in chip size. I

DBKBBITH

Vessenes - redirect

1 shouldn't say chip size. I'll withdraw that.

2 Mr. Reyhani talked about a change in chip
3 architecture, and then he asked you if you knew about that
4 change in chip architecture.

5 Was that change within your control?

6 A. No.

7 Q. Was it within CoinLab's control?

8 A. No.

9 Q. Was it within Alydian's control?

10 A. No.

11 Q. Mr. Reyhani also talked about you mining individually
12 today and the way that you mined in 2011. How did you mine in
13 2011?

14 A. I purchased a graphics card from Best Buy.

15 Q. And how much did that cost you?

16 A. It was \$150. It was fun.

17 Q. Would it be profitable if you did that today?

18 A. No.

19 Q. Would it have been profitable in August?

20 A. No.

21 Q. Mr. Reyhani also pointed out that there was a missing entry
22 for Dan Gallancy in the CoinLab board presentation.

23 Why was there a missing entry in the board
24 presentation?

25 A. Well, as I was saying, it looked that the business might be

DBKBBITH

Vessenes - redirect

1 impracticable. You know, I had a fiduciary duty to the
2 corporation. We've got to figure out how to do the best thing
3 for the corporation. So if there's a contract that looks like
4 there's nothing due, then we need to estimate results of that.

5 Q. Did Dan ever threaten to sue you?

6 A. Yes.

7 Q. Did he threaten to sue you before that presentation?

8 A. I don't remember the dates. I think it's quite likely,
9 though.

10 MR. SANTORI: Thank you. No more questions.

11 THE WITNESS: Can I get down?

12 THE COURT: Just a minute.

13 THE WITNESS: Okay.

14 RECROSS EXAMINATION

15 BY MR. REYHANI:

16 Q. Just so we're abundantly clear, when you assessed the
17 situation of going to third-party miners, you didn't do it
18 because the returns to CoinLab would not be there. Correct?

19 A. That's not correct.

20 Q. That's not correct.

21 But they would still be mining bitcoins for CoinLab.
22 Correct?

23 A. One could pay bitcoin miners to mine coins for CoinLab,
24 yes.

25 Q. But you did not see the return on capital for CoinLab.

DBKBBITH

Vessenes - recross

1 Correct?

2 A. I'm not sure I understand. I think no model we saw showed
3 that the amount that that cost would ever be paid back.

4 Q. All right. So CoinLab would be out-of-pocket money.

5 A. I would presume so.

6 MR. REYHANI: Okay. Nothing further, your Honor.

7 MR. SANTORI: Nothing further, your Honor.

8 THE COURT: Thank you, sir. You're excused.

9 THE WITNESS: Thank you, your Honor.

10 (Witness excused)

11 MR. TOWNSEND: Your Honor, defendants call Hans Olsen
12 to the stand.

13 HANS OLSEN,

14 called as a witness by the Defendants,

15 having been duly sworn, testified as follows:

16 THE DEPUTY CLERK: Please state your full name and
17 spell your first name and last name slowly for the record.

18 THE WITNESS: Name is Hans Olsen. First name H-a-n-s,
19 last name O-l-s-e-n.

20 THE DEPUTY CLERK: Thank you, Mr. Olsen. Please be
21 seated.

22 MR. TOWNSEND: Your Honor, may I approach with the
23 binder?

24 THE COURT: Yes.

25 DIRECT EXAMINATION

DBKBBITH

Olsen - direct

1 BY MR. TOWNSEND:

2 Q. Good afternoon, Mr. Olsen. Can I draw your attention to
3 the Tab 12 of the binder?

4 A. Okay.

5 Q. Do you recognize this document?

6 A. I do.

7 Q. What is this?

8 A. It is the summary of returns for contemplated --

9 Q. No, I'm sorry. You're on Tab 11, I think. Tab 12 should
10 be your CV.

11 A. Oh, sorry. Yes, that's my CV.

12 MR. TOWNSEND: Barring any objection, move to admit
13 Mr. Olsen's CV as Defendants' Exhibit 6.

14 THE COURT: Seven.

15 MR. REYHANI: Seven.

16 THE COURT: It's admitted.

17 (Defendants' Exhibit 7 received)

18 Q. Mr. Olsen, can you describe your educational background?

19 THE COURT: Maybe we can speed this up just a little
20 bit.

21 MR. TOWNSEND: Sure.

22 THE COURT: You've given me a declaration, Mr. Olsen.

23 Do you affirm all of the statements in that
24 declaration?

25 THE WITNESS: I do.

DBKBBITH

Olsen - direct

1 THE COURT: Thank you.

2 Anything you want to tell us in addition to that?

3 THE WITNESS: Well--

4 THE COURT: No, no. Any questions with respect to
5 additions?

6 MR. TOWNSEND: I would just stay at the high level.

7 BY MR. TOWNSEND:

8 Q. Mr. Olsen, in your experience, how long does it take to
9 launch a bitcoin mining operation?

10 A. With today's requirements for the technology, to do a
11 reasonably effective mining operation, you would take anywhere
12 from nine to 18 months, depending on how you approach it.

13 Q. And how would you suggest that it be approached given
14 today's technology?

15 A. Well, if you have design teams, if you have technology
16 access, you may be able to do it in a nine-month period to get
17 to the ASIC device. After that, then you have to put it in
18 your hosting environment and start your mining operation.

19 For most conventional models, would take you like 12
20 to 15 months, but in the best case you might be able to do it
21 in nine months.

22 THE REPORTER: Did you say ASIC?

23 THE WITNESS: ASIC, A-S-I-C.

24 THE COURT: What does that stand for?

25 THE WITNESS: It stands for application-specific

DBKBBITH

Olsen - direct

1 integrated circuit. And it's really used today in the bitcoin
2 community wrongfully. It's not really an ASIC. An ASIC is a
3 term that was used in the late '80s and the '90s for custom
4 devices. Today an ASIC, as it's referred to in the bitcoin
5 community, is really a customizing.

6 BY MR. TOWNSEND:

7 Q. And have you observed in your experience in the bitcoin
8 mining industry changes in technology that have affected the
9 practicability and viability of bitcoin mining?

10 A. Yes, I have. When I first became involved with bitcoins,
11 the technology was at 110-nanometer technology. It's rapidly
12 progressed over the last 12 months to a 28-nanometer
13 technology, which is hydrofast. Even in the technology
14 communities that we're in today with semiconductors, technology
15 progressions typically do not happen that quickly. There's
16 been a lot of developments, a lot of mining efforts going into
17 bitcoin mining and the technology accelerations have been
18 unprecedented.

19 Q. And in addition to the technology acceleration in the
20 chips, are there other technology accelerations that were
21 unanticipated?

22 A. Well, I think the capital required for hosting these
23 advanced technologies is, again, happening faster than typical
24 and certainly faster than anticipated.

25 Q. And in your experience, can you buy mining equipment, other

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Olsen - direct

1 capital and operational expenditures, on credit for a bitcoin
2 mining operation?

3 A. Well, in our case we're not able to do that. We have been
4 able -- with one exception. We are required to pay for all our
5 material up front. In part due to concerns about the bitcoin
6 business, bitcoin community; in part due to the lack of capital
7 that CoinLab/Alydian has had available to it.

8 Q. And can you describe to me, to the Court, briefly the
9 complications associated with cooling bitcoin mining rates?

10 A. Yeah. The operation or the intricate circuits in a bitcoin
11 mining application is unusual in the way that it is operating
12 24 hours a day, constantly. It is on all the time. Most
13 semiconductor devices are not operating at its peak performance
14 constantly. In a mining application, it operates at 100
15 percent constantly. It requires levels of cooling, again, that
16 are unprecedented. They only see similar in other server
17 applications. But even in server applications, the power
18 requirement is less than half, sometimes a third, of what is
19 required for a mining operation. And that places really,
20 really stringent requirements for cooling which can only be
21 attained in a data center environment, which brings additional
22 cost and complexity into operating a mining business.

23 Q. And, in fact, you have to have a special section of the
24 data center that has additional cooling. Is that right?

25 A. That's how we've been able to work it out with our data

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Olsen - direct

1 centers, is that we have special sections of the data center
2 that has additional cooling over and above what's normally
3 provided.

4 Q. And despite the additional cooling, you've had fires. Is
5 that right?

6 A. Yes.

7 Q. Can you describe those fires? Or maybe it's just one fire?

8 A. One fire.

9 Q. Okay.

10 A. In spite of the cooling, some of the cooling design in the
11 initial stages was not adequate to sufficiently cool the
12 equipment. And, in fact, it caused some of the insulation on a
13 wiring harness to catch on fire.

14 Q. And did that destroy some of the mining rigs?

15 A. It did.

16 Q. And is there a relationship between the cooling obligation
17 and the cooling requirements and the chip size?

18 A. There is. The older the technology-- and here, when you
19 say "older," it's 110 nanometer and 65 nanometer. The older
20 the technology, the more power is required. The advanced
21 technology, 28 nanometer, requires less cooling.

22 Q. But it requires more electricity. Right?

23 A. But it requires-- it requires -- to get the same amount of
24 mining capacity, it does require more, yeah.

25 Q. And the Court asked the question earlier about whether or

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Olsen - direct

1 not mining machines were connected to the internet.

2 Are they connected to the internet?

3 A. They are, yes.

4 Q. But they're not connected to the internet in the same way
5 that a normal server would be. Is that correct?

6 A. The physical connection is similar.

7 Q. Is similar. Okay.

8 A. Right.

9 Q. Did you meet with Mr. Gallancy in the course of his due
10 diligence on behalf of Cedar Hill, Crystal Island?

11 A. I did.

12 Q. And can you describe those meetings?

13 A. We met in mid-August as part of the due diligence efforts
14 on behalf of Cedar Hill. And I participated, together with
15 others of staff members, in a session over a period of two,
16 three days.

17 Q. And did you discuss financial models with him at that
18 time?

19 A. We did.

20 Q. And to your recollection, did those financial models
21 contemplate that the proceeds from bitcoin mining would pay for
22 capital and operational expenditures?

23 A. Correct.

24 Q. And do your vendors generally accept bitcoins for
25 equipment and hosting and other operational and capital

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Olsen - direct

1 expenditures?

2 A. None that I'm aware of.

3 Q. So you're required to convert bitcoins to cash in order to
4 pay your vendors. Is that right?

5 A. Correct.

6 THE COURT: Tomorrow, 10:00. Thank you.

7 MR. TOWNSEND: Thank you, your Honor.

8 MR. REYHANI: Thank you, your Honor.

9 (Adjourned to November 21, 2013, at 10:00 a.m.)

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